



**NAVAL
POSTGRADUATE
SCHOOL**

MONTEREY, CALIFORNIA

THESIS

ECONOMIC DIMENSIONS OF CIVIL CONFLICTS

by

Serdar Hacisalihoglu

September 2012

Thesis Advisor:

Second Reader:

Robert E. Looney

Ryan Gingeras

Approved for public release; distribution is unlimited

THIS PAGE INTENTIONALLY LEFT BLANK

REPORT DOCUMENTATION PAGE
Form Approved OMB No. 0704-0188

Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.

1. AGENCY USE ONLY (Leave blank)	2. REPORT DATE September 2012	3. REPORT TYPE AND DATES COVERED Master's Thesis
4. TITLE AND SUBTITLE Economic Dimensions of Civil Conflicts		5. FUNDING NUMBERS
6. AUTHOR(S) Serdar Hacisalihoglu		
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000		8. PERFORMING ORGANIZATION REPORT NUMBER
9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES) N/A		10. SPONSORING/MONITORING AGENCY REPORT NUMBER
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government. IRB Protocol number <u>N/A</u> .		
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution is unlimited		12b. DISTRIBUTION CODE

13. ABSTRACT (maximum 200 words)

The thesis has five chapters: (1) an introduction, (2) the economic risk factors causing civil conflicts, (3) the economic dimensions of peace building (4) a Kosovo case study, and (5) the conclusion.

Chapter II discusses the economic risk factors that cause civil conflicts. Specific economic characteristics, such as the availability of natural resources, enduring economic decline (with its effects of low incomes and high unemployment), and diasporas make countries more prone to civil wars, both by providing revenues to insurgent groups and by weakening the power of the central authority.

Chapter III provides information about war economies and presents the economic challenges of unstable post-conflict environment. The chapter emphasizes that challenges such as a fragile economic environment, illicit economic activities and peace spoilers must be overcome to achieve enduring peace.

Chapter IV introduces a Kosovo case study to apply the economic dimensions discussed in the previous chapters. The chapter provides the background that led to civil war, explains the post-conflict economic environment, discusses the international community's economic-recovery efforts, and recommends policy responses for economic development. Chapter V summarizes the main issues presented in the chapters. The conclusion also emphasizes the importance of studying economic dimensions to implement effective policies that will secure peace and provide development.

14. SUBJECT TERMS Civil conflict, insurgency, armed groups, economic risk factors, war economies, post-conflict environment, post-conflict economic challenges, economic reconstruction, economic development, international community, Kosovo.			15. NUMBER OF PAGES 83
16. PRICE CODE			
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UU

THIS PAGE INTENTIONALLY LEFT BLANK

Approved for public release; distribution is unlimited

ECONOMIC DIMENSIONS OF CIVIL CONFLICTS

Serdar Hacisalihoglu
First Lieutenant, Turkish Army
B.S., Turkish Military Academy, 2004

Submitted in partial fulfillment of the
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES
(STABILIZATION AND RECONSTRUCTION)**

from the

NAVAL POSTGRADUATE SCHOOL
September 2012

Author: Serdar Hacisalihoglu

Approved by: Robert Looney
Thesis Advisor

Ryan Gingeras
Second Reader

Daniel Moran
Chair, Department of National Security Affairs

THIS PAGE INTENTIONALLY LEFT BLANK

ABSTRACT

The thesis has five chapters: (1) an introduction, (2) the economic risk factors causing civil conflicts, (3) the economic dimensions of peace-building (4) a Kosovo case study, and (5) the conclusion.

Chapter II discusses the economic risk factors that cause civil conflicts. Specific economic characteristics, such as the availability of natural resources, enduring economic decline (with its effects of low incomes and high unemployment), and diasporas make countries more prone to civil wars, both by providing revenues to insurgent groups to sustain their rebellions and by weakening the power of the central authority to suppress insurgent activities.

Chapter III provides information about war economies, and presents the economic challenges of unstable post-conflict environment. The chapter emphasizes that challenges such as a fragile security and economic environment, illicit economic activities and peace spoilers must be overcome to achieve enduring peace. The chapter also gives some proper policy responses to cope with them.

Chapter IV introduces a Kosovo case study to apply the economic dimensions discussed in the previous chapters. The chapter provides the background that led to civil war, explains the post-conflict economic environment, discusses the international community's economic-recovery efforts, and recommends policy responses for economic development.

Chapter V summarizes the main issues presented in the chapters. The conclusion also emphasizes the importance of studying economic dimensions to implement effective policies that will secure peace and provide development.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
	A. THE MAJOR RESEARCH QUESTION	1
	B. IMPORTANCE.....	1
	C. PROBLEMS AND HYPOTHESES	2
	D. LITERATURE REVIEW	3
	E. METHODS AND SOURCES	7
	F. THESIS OVERVIEW	8
II.	ECONOMIC RISK FACTORS CAUSING CIVIL CONFLICTS	9
	A. INTRODUCTION.....	9
	B. NATURAL RESOURCES	9
	1. The Role of Natural Resources in Financing Conflict and Motivating Rebels to Fight for Resource Capture.....	10
	2. Mismanagement of Natural Resources	12
	3. Unequal Allocation of Revenues	14
	4. Eliminating Risk Factors Stemming From Natural Resources	15
	C. POOR ECONOMIC PERFORMANCE OF GOVERNMENTS	16
	1. Failed States.....	17
	2. Economic Decline	18
	3. Low Incomes and High Unemployment Rates	19
	4. Eliminating Risk Factors Stemming From Poor Economic Performance of Governments	20
	D. THE AVAILABILITY OF DIASPORA	21
	1. Diaspora Effect on Funding Violence	21
	2. Eliminating Risk Factors Stemming from Diaspora's Funding Grievances	22
III.	ECONOMIC DIMENSIONS OF PEACE-BUILDING	25
	A. ECONOMIC CHALLENGES IN WAR-TORN COUNTRIES	25
	1. War Economies	25
	2. Economic Challenges in Peace Negotiations.....	27
	3. Dealing with Peace Spoilers	28
	4. Fragile Environment.....	29
	5. Informal Economies.....	30
	B. POLICY OPTIONS FOR COPING WITH THE ECONOMIC CHALLENGES IN A POST-CONFLICT ENVIRONMENT	31
	1. Establishing Global Control Regimes to Curtail Financial Capability of Armed Groups to Resume Violence.....	31
	2. Alleviating Socioeconomic Problems.....	33
	3. Building New Economic Institutions	34
	4. New Visions for Future.....	35
IV.	CASE STUDY: KOSOVO	37
	A. INTRODUCTION.....	37

B.	COUNTRY PROFILE AND HISTORICAL BACKGROUND	39
1.	Country Profile.....	39
2.	Historical Background.....	40
C.	ECONOMIC CAUSES OF THE KOSOVO WAR.....	41
1.	Low Incomes and a High Unemployment Rate.....	42
2.	The Diaspora	42
3.	Neighborhood Effects	43
D.	CHALLENGES FOR ECONOMIC RECOVERY.....	44
1.	The Devastation of War, Volatile Security Environment and Political Uncertainty	44
2.	Transition to Market Economy	45
3.	Property Rights	46
4.	Informal Economies.....	46
5.	Coordinating Post-Conflict Reconstruction Efforts	47
E.	POST-CONFLICT ECONOMIC RECOVERY EFFORTS	48
1.	International Priorities	48
2.	Post-Conflict Economic Recovery Policies	49
3.	Prospectus for Economic Development	52
a.	<i>Positive.....</i>	52
b.	<i>Obstacles for Economic Recovery in Kosovo.....</i>	53
F.	RISK OF REVERT TO VIOLENCE	55
V.	CONCLUSION	57
LIST OF REFERENCES		61
INITIAL DISTRIBUTION LIST		67

LIST OF FIGURES

Figure 1.	Risk of civil conflict and dependence on primary-commodity exports	11
Figure 2.	Economic performance and the risk of civil war	17
Figure 3.	Main incentives for joining a rebel organization.	19
Figure 4.	Kosovo, poverty and extreme poverty headcount, 2009.....	40
Figure 5.	Kosovo, revenue (% of GDP) between years 2002–11.	51
Figure 6.	Kosovo, unemployment rate (in %) between 2003–10.....	51
Figure 7.	Kosovo, GDP% Growth between years 2002–11.....	52

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF ACRONYMS AND ABBREVIATIONS

BPAK	Banking and Payments Authority of Kosovo
CBAK	Central Banking Authority of Kosovo
CFA	Central Fiscal Authority
DDR	Disarmament, Demobilization, and Reintegration
DRC	Democratic Republic of Congo
EITI	Extractive Industry Transparency Initiative
EU	European Union
FARC	Revolutionary Armed Forces of Colombia
FLEGT	Forest Law Enforcement, Governance and Trade
GDP	Gross Domestic Products
IMF	International Monetary Fund
KEK	Kosovo Energy Corporation
KFOR	Kosovo Force
KLA	Kosovo Liberation Army
MEB	Micro Enterprise Bank
NATO	North Atlantic Treaty Organization
OSCE	Organization for Security and Co-operation in Europe
PISG	Provisional Institutions of Self-Government
PWYP	Publish What You Pay Campaign
SFRY	Socialist Federal Republic of Yugoslavia
SMEs	Small and Medium-size Enterprises
SRSG	Special Representative of the Secretary General
UN	United Nations

UNHCR	United Nations High Commissioner for Refugees
UNMIK	United Nations Mission in Kosovo
USAID	United States Agency for International Aid

ACKNOWLEDGMENTS

This work is dedicated to my wife, Ozge, and my daughter, Yagmur. I would like to thank my wife Ozge for her personal support and great patience at all times. It would not have been possible to complete this thesis without the help, encouragement and devotion of my wife. I would also like to thank my parents, two sisters, and brother. They were always supporting me with their best wishes.

I offer my deepest thanks to all the professors who have made my time at the Naval Postgraduate School one of the richest experiences of my life. Finally, to Professor Looney, and Professor Gingeras, thank you for your tremendous guidance, support and friendship throughout this process.

THIS PAGE INTENTIONALLY LEFT BLANK

I. INTRODUCTION

A. THE MAJOR RESEARCH QUESTION

This thesis claims that economic perspectives should be put into consideration in a much broader sense when analyzing civil wars, due to their impacts on conflict dynamics. Many researches demonstrate that the rise of civil war, its intensity and character, its maintenance, its ending, and the risk of a return violence in post-conflict settings, correlate with economic variables rather than social grievances.¹ Social inequalities, and ethnic, religious and regional differences are useful mediums for gathering people around a common cause, but the financial capability of these people to initiate and sustain a war against central authority is the main factor that spurs violence.² The primary question addressed in this thesis is as follows: What are the economic risk factors that make countries more prone to civil wars, and how should economic challenges in post-conflict environments be dealt with in order to prevent a return to violence?

B. IMPORTANCE

People generally believe that social grievances, and religious and ethnic hostilities are the main causes of armed conflicts.³ Economic analysis demonstrates that social grievances such as inequalities, and ethnic and religious differences are useful media for armed groups to use in stirring up dissension and recruiting new rebels more easily, but economic agendas, or at least the economic feasibility of military struggle have much more influence on spurring violence.⁴ Paul Collier claims that: “*Civil war occurs where*

¹ Karen Ballentine, “Beyond Greed and Grievance: Reconsidering the Economic Dynamics of Armed Conflict,” in Karen Ballentine & Jake Sherman(eds.), *The Political Economy of Armed Conflict, Beyond Greed & Grievance*,(Colorado: Lynne Rienner Publishers,2003), 259.

² Paul Collier, “Economic Causes of Civil Conflict and Their Implications for Policy,” in Crocker, Hampson and Aall (eds.), *Leashing the Dogs of War: Conflict Management in a Divided World* (Washington, D.C. : United States Institute of Peace Press,2007), 197.

³ David Keen, “Incentives and Disincentives for Violence,” in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars*” (Boulder: Lynne Rienner Publishers, 2000), 20.

⁴ Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It* (New York:Oxford University Press, 2007), 23.

*rebel organizations are viable.*⁵ His explanation of the failure of the Michigan Militia and success of the Revolutionary Armed Forces of Colombia (FARC) to initiate insurgency lies in their opportunities to raise money rather than the ideals they claim to embrace. He states:

Regardless of why the organization is fighting, it can fight only if it is financially viable during the conflict. War cannot be fought just on hopes or hatreds. Predatory behavior may not be the objective of the rebel organization, but it is its means of financing the conflict.⁶

Furthermore, the political economy of civil conflict has impacts on peace-building efforts. Studies on conflicts in Somalia, Sierra Leone, Sudan, Kosovo, Afghanistan and many other civil war-affected countries indicate that violence can serve a range of political and economic functions for combatants, civilians and foreign actors taking part in the conflict. In most cases, groups, benefiting from war economies may not have an interest ending the violence.⁷ Therefore, defining the economic risk factors for preventing conflicts, understanding war economies for better evaluating socio-economic realities and presenting post-conflict economic challenges to create appropriate policy responses are three important tasks to be addressed by policy-makers.

C. PROBLEMS AND HYPOTHESES

There are two hypotheses that can be formulated based on the literature analyzing economic causes of civil conflicts. The first hypothesis assumes that, the risk of civil conflict correlates with the economic conditions in a given country. Countries having valuable natural resources, suffering from a poor economic performance of their governments for a long period of time, and having a strong diaspora that funds grievances are more susceptible to civil conflicts. Insurgency behavior is significantly dependent on the economic circumstances of a given country. Defining and analyzing these risks, and introducing ways to eliminate them may yield valuable results for conflict-prevention.

⁵ Collier, “Economic Causes of Civil Conflict,” 197.

⁶ Ibid., 198.

⁷ Keen, “Incentives and Disincentives for Violence,” 24.

The second hypothesis posits that the economic challenges presented in the post-conflict country, such as the fragile economic environment, dealing with peace spoilers, harnessing informal economies, and persuading rebels to disarm by shaping new futures for them have impacts on achieving durable peace. An inability to cope with these challenges may both cause a return to violence and hinder economic development.

D. LITERATURE REVIEW

Based on empirical data over the period 1965–1999, Paul Collier claims that the risk of civil war is strongly correlated with economic variables rather than social grievances. Contrary to general belief, inequality, the lack of liberal democratic norms and values, and ethnic and religious disparities do not have a significant impact on the risk of civil conflict. His main argument is that “*civil war occurs where rebel organizations are viable.*” He asserts that “*dependence on primary-commodity exports and low national income*” are the main factors propelling civil conflicts.⁸ On the other hand, David Keen, who is more focused on the interactions of grievances and the economic motivations of belligerents, argues that political agendas have been replaced by economic agendas and economic motivations, and he analyzes the economic functions of warfare.⁹ Similarly, Karen Ballentine and Heiko Nitzschke evaluate the influences of both economic and social elements on spurring civil conflicts:

Economic incentives and opportunities have not been the only or even the primary cause of these armed conflicts; rather, to varying degrees, they interacted with socioeconomic and political grievances, interethnic disputes, and security dilemmas in triggering the outbreak of warfare.¹⁰

The thesis values the importance of both the social and economic motivations of belligerents, as well as their roles in stirring dissension in different circumstances. However, the thesis considers the financial ability of the rebels to sustain their insurgent activities as the fundamental cause of civil wars.

⁸ Collier, “Economic Causes of Civil Conflict,” 197.

⁹ Keen, “Incentives and Disincentives for Violence,” 22.

¹⁰ Ballentine, “Beyond Greed and Grievance,” 260.

Jonathan Goodhand addresses war economies by dividing them into three types; combat, shadow and coping economies. He claims that these interlinked economies involve different actors with dissimilar motivations using different mediums to implement their economic activities. In addition to predatory and profit-seeking concerns, coping and survival are the other considerations that should be taken into account when dealing with war economies.¹¹ Although he discusses the difficulty of transforming war economies into peace-time conditions, his analysis does not include the question of how this transformation could be managed successfully. The thesis fills the gap by explaining the social and political aspects of economic activities in wartime in order to implement proper policies for a smooth transformation to peace-time conditions without causing social unrest.

Achim Wennmann claims that peace-makers usually tend to focus on political and military issues in the initial stages of post-conflict stabilization and reconstruction missions, and he emphasizes the need for focusing more on the economic recovery of a given country to achieve durable peace.¹² He presents “*the opportunities and pitfalls of addressing economic issues in peace processes.*” Although he recommends some policies, like “*charting new futures, constructing new partnerships with economic actors and engaging the business community,*” his article does not deal much with the economic problems and challenges presented in the war-torn country. The thesis introduces economic challenges, such as the fragile economic environment, illicit economic activities and peace spoilers, then presents the policy recommendations. It is not easy to offer an effective guideline to any given country since the distinct economic characteristics of different countries entail dissimilar solutions. Nonetheless, establishing

¹¹ Jonathan Goodhand, “From War Economy to Peace Economy? Reconstruction and State Building in Afghanistan,” *Journal of International Affairs*, Vol. 58, No. 1, (2004), 155. Accessed August 22, 2012. http://www.relooney.info/SI_Expeditionary/Afghanistan-Entrepreneurship_5.pdf

¹² Achim Wennmann, “Peace Processes, Business and New Futures after War,” in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series, (New York : Routledge for the International Institute for Strategic Studies, 2010),15.

global control regimes to specific goods to curb insurgents' revenues¹³, building robust economic institutions to overcome shadow economies¹⁴, and alleviating socio-economic problems by providing economic opportunities to the population¹⁵ are proven fundamental responses to these challenges.

Nitzschke and Studdard discuss the impacts of the political economy on the mediation process and the design of the peace agreement. They consider the existence of lucrative natural resources and their effects on the number of profit-seekers as key elements in an unsuccessful peace-making process. Their study emphasizes the need for incorporating insurgency groups in peace processes, which may require both political and economic arrangements including; control over mines, markets and economic and industrial infrastructure.¹⁶ It is important that combatant groups should have some financial expectation about the future. A peace agreement that incorporates positive economic elements for anyone, including loot-seekers, may become an encouraging force in establishing long-lasting peace. However, balancing combatant demands with economic realities may bring negotiations to a halt. The combatants, comparing their profits in war and the expected benefits of peace, may act as spoilers of the peace processes.¹⁷ Their findings are particularly important in the Kosovar case because

¹³ Karen Ballentine and Heiko Nitzschke, "The Political Economy of Civil War and Conflict Transformation," Berghof Research Center for Constructive Conflict Management (2005), 11. Accessed August 22, 2012. http://www.berghof-handbook.net/documents/publications/dialogue3_ballentine_nitzschke.pdf

¹⁴ Paivi Lujala, Siri Aas Rustad and Philippe Le Billon, "Valuable Natural Resources in Conflict Affected States," in Mats Berdal and Achim Wenmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series (New York : Routledge for the International Institute for Strategic Studies, 2010), 133.

¹⁵ Johanna Mendelson Forman, "Achieving Socioeconomic Well- Being," *Washington Quarterly*, Autumn 2002, 126. Accessed August 22, 2012. http://pdf.usaid.gov/pdf_docs/PCaab119.pdf.

¹⁶ Heiko Nitzschke and Kaysie Studdard, "The Legacies of War Economies: Challenges and Options for Peacemaking and Peacebuilding," *International Peacekeeping*, 12, 2 Summer 2005, (London: Routledge), 226.

¹⁷ Karen Ballentine and Heiko Nitzschke, "The Political Economy of Civil War and Conflict Transformation," 6.

current criminal activities may be related to some policy mistakes on dealing with strong criminal organization in the peace processes.¹⁸

Ballentine and Nitzschke claim that contemporary insurgency activities need to finance themselves in order to sustain their rebellion. Their ability to get revenues is highly related to their global trading capacity. They recommend that decision-makers in the peace-making process consider curtailing and managing resource flows both regionally and internationally by implementing control regimes. Rather than struggling to force armed groups to compromise, or intervening using military force, diminishing self-financing abilities may yield valuable results. Commodity-sanction regimes aimed at the predatory exploitation of natural resources, and interdiction regimes targeted at organized crime activities, drug and human trafficking, corruption and money laundering can be helpful instruments to cut revenue flows to rebellion groups.¹⁹

Lujala, Rustad and Le Billon present the poor governance of natural resources as the main causes of civil conflicts in many resource dependent countries. As they stated: *“Unsurprisingly, badly governed countries with poor populations living in areas with easily lootable resources are among the most challenging contexts.”*²⁰ Resource and development relation largely depends on the quality of the governance. For example, in Nigeria, resource revenues are absorbed by corrupt national and local officials, so that no remains for the development of the Niger delta. Likewise, in Myanmar, large amounts of revenue were spent by the governments to increase the military capacity of their rule in order to more easily suppress their people.²¹

James Cockayne addresses the peace-building efforts in his study *“Crime, Corruption and Violent Economies.”* He argues that peace-building efforts should focus on giving positive economic incentives to criminal organizations. Creating better prospects with economic development assist to transform them to legitimate economic

¹⁸ Alexandros Yannis, “Kosovo: The Political Economy of Conflict and Peacebuilding,” in Karen Ballentine & Jake Sherman(eds.), *The Political Economy of Armed Conflict, Beyond Greed & Grievance* (Colorado: Lynne Rienner Publishers,2003), 187.

¹⁹ Ballentine and Nitzschke, “The Political Economy of Civil War and Conflict Transformation,” 11.

²⁰ Lujala et al., “Valuable Natural Resources,” 134.

²¹ Ibid., 135.

actors. He claims that if these organizations view their criminal activities as more profitable, they may decide to continue their illegal activities in peace-time.²² However, it is difficult to distinguish when criminal armed groups will be opponents and when they become a partner in the peace process. The thesis will present some of the challenges of dealing with these criminal organizations on the domestic and international levels.

In his article “*Achieving Socioeconomic Well-Being in Post-Conflict Settings*,” Forman presents the difficulties of achieving socio-economic well-being in post-conflict reconstruction mission. He claims that providing basic needs to only refugees and displaced person is not proper way to address the problem. Almost all citizens may in need of basic human needs like food and shelter. He emphasizes the need for providing health facilities, educational systems, and a socially secure environment to effectively address initial socio-economic problems in conflict affected societies. Then, subsequent socio-economic efforts should be directed to the improvement of physical infrastructure, creating employment opportunities, establishing a legal regulatory framework, forming financial institutions, and providing conditions for international trade and investments.²³ The thesis will test his findings by applying them to a Kosovo case, and add some other particular requirements for achieving socio-economic prosperity in Kosovo.

E. METHODS AND SOURCES

This thesis will focus on a case-study approach by analyzing the conflict in Kosovo. The case provides an opportunity to test different argument about the economic risk factors causing civil conflicts, war economies, the economic challenges in a post-conflict environment, and giving proper policy responses to them. Many examples are drawn from other civil war experiences to illustrate the economic issues on conflict prevention and post-conflict peace-building, and to compare and contrast them to Kosovo case.

²² James Cockayne, “Crime, Corruption and Violent Economies,” in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series (New York : Routledge for the International Institute for Strategic Studies, 2010) 204.

²³ Forman, “*Achieving Socioeconomic Well-Being in Post-Conflict Settings*,” 126.

I will utilize the sources presented in the literature review section of this proposal. For raw and statistical data, the primary sources will be from reliable international organizations, such as International Monetary Fund, the World Bank, and the United Nations.

F. THESIS OVERVIEW

The thesis has five chapters: (1) an introduction, (2) the economic risk factors causing civil conflicts, and ways to eliminate them, (3) the economic dimensions of peace-building (4) a Kosovo case study, and (5) the conclusion.

Chapter II discusses the economic risk factors that cause civil conflicts. Specific economic characteristics of a given country, such as the availability of natural resources, enduring economic decline (with its effects of low incomes and high unemployment), and diasporas make countries more prone civil wars both by providing revenues to insurgent groups to sustain their rebellions and by weakening the power of the central authority to suppress insurgent activities.

Chapter III provides information about war economies, and presents the economic challenges of unstable post-conflict environment. The chapter emphasizes the challenges such as a fragile economic environment, illicit economic activities and peace spoilers must be overcome to achieve enduring peace. The chapter also gives some proper policy responses to cope with them.

Chapter IV introduces a Kosovo case study to apply the economic dimensions discussed in the previous chapters. The chapter provides the background that led to civil war, explains the post-conflict economic environment, discusses the international community's economic-recovery efforts, and recommends policy responses for economic development.

Chapter V summarizes the main issues presented in the chapters. The conclusion also emphasizes the importance of studying economic dimensions to implement effective policies that will secure peace and provide development.

II. ECONOMIC RISK FACTORS CAUSING CIVIL CONFLICTS

A. INTRODUCTION

The incidence of civil war is associated with an armed group's financial capability to sustain its costly struggle against government forces in a prolonged conflict. Initiating a war against a central authority requires at least forming a military organization, and providing equipment, weapons and ammunitions to them in a continuous manner.²⁴ Social grievances which can be rooted in ancient hatreds, inequality, a lack of democracy, and ethnic and religious divisions are useful media for the leaders of an insurgent group to legitimize their actions and gather dissatisfied people under a common cause; but they cannot provide the money and resources for the expensive undertaking of fighting against state forces. On the other hand, specific economic characteristics of a given country, such as the availability of natural resources, enduring economic decline with its effects of low incomes and a high unemployment rate, and diasporas increase the risk of civil war both by providing revenues to insurgent groups to sustain their rebellions and by weakening the power of the central authority to suppress insurgent activities.²⁵

B. NATURAL RESOURCES

The availability of valuable natural resources makes countries more inclined to experience severe, long-lasting and recurring armed conflicts for several reasons. First, the availability of valuable natural resources provides revenues for armed groups to finance their military campaigns. Furthermore, the combatants are motivated to fight in order to capture resources.²⁶ Second, reliance on natural resources hinders economic development by reducing economic growth and increasing poverty. Slow growth intensifies unemployment which makes it easy for insurgent groups to recruit new

²⁴ Ian Bannon and Paul Collier, "Natural Resources and Violent Conflict: What We Can Do?," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions* (Washington D.C.:World Bank Publications,2003), 3.

²⁵ Paul Collier et al., *Breaking the Conflict Trap: Civil War and Development Policy* (Washington D.C.:World Bank Publications, 2003), 53.

²⁶ Lujala et al., "Valuable Natural Resources," 124

rebels.²⁷ Third, severe disagreements about sharing the revenues from lucrative natural resources fuel greed and grievances among certain groups in the society. The perceptions about unequal sharing of revenues may cause secessionist movements in the resource-rich country.²⁸

1. The Role of Natural Resources in Financing Conflict and Motivating Rebels to Fight for Resource Capture

The availability of lucrative natural resources such as oil, diamonds, timber and drugs increases the risk of civil conflict by providing high and easy revenues to rebels to initiate and maintain a war against central authority. Rebel organizations acquire large amount of money from lucrative natural resources whether by directly looting or heavily taxing them. Furthermore, the presence of lucrative natural resources attracts the leaders of insurgent groups, or even ordinary members to continue confronting the central authority in order to maintain their controls on the resources.²⁹ Rebel organizations acquire large sums of money from primary commodity exports with controlling the routes of valuable produced exports from the production place to international markets. The insurgencies in Sierra Leone in 1990s and Angola were long lasting because of belligerents' motivation of resource capture.³⁰

Collier argues that the countries that are heavily reliant on primary commodity exports as a main revenue resource are more prone to experience civil conflicts. The primary commodity exports present opportunities for predatory behavior, both for insurgent groups and governments. Governments seek to benefit from primary commodity exports by getting tax revenues whereas rebel groups seek to exploit them to sustain their military activities. Many crime groups desiring to continue exploiting lucrative resources transform themselves into rebellious groups in order to have enough

²⁷ Michael Ross, "The Natural Resource Curse: How Wealth Can Make You Poor," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions* (Washington D.C.:World Bank Publications, 2003), 19.

²⁸ Lujala et al., "Valuable Natural Resources," 124,125.

²⁹ Ross, "The Natural Resource Curse," 30.

³⁰ Lujala et al., "Valuable Natural Resources," 124.

members to confront with the government's forces.³¹ According to Collier's analysis with Hoeffler, if a country's primary commodity export dependence is twenty-six percent of its gross domestic products (GDP), it has a risk of conflict of twenty-three percent. If it had no dependence on primary commodity exports, the risk of conflict fall to only one-half of one percent.³² Figure 1 shows the risk of civil war in low-income countries according to their dependence on primary commodity exports.³³

Risk of Civil Conflict

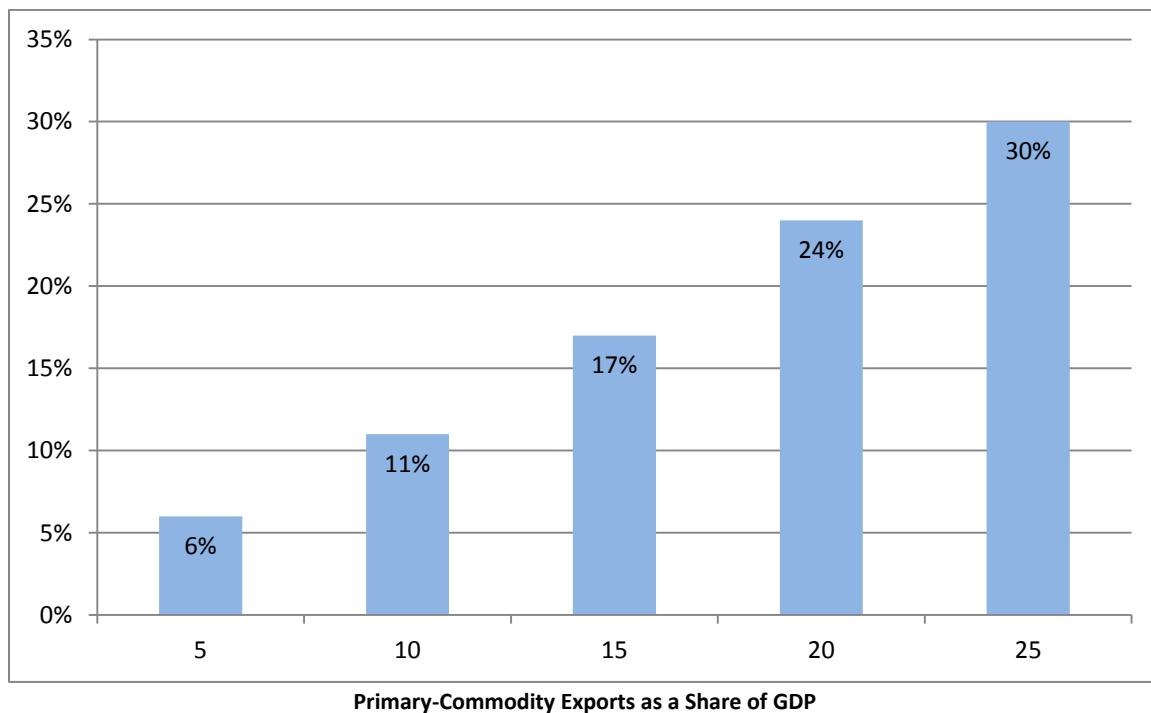


Figure 1. Risk of civil conflict and dependence on primary-commodity exports

³¹ Collier, "Economic Causes of Civil Conflict," 205

³² Ibid., 201.

³³ Bannon and Collier, "Natural Resources and Violent Conflict," 3.

In most cases, the risk and type of civil conflict is related to the mode of exploitation of specific resources. Lootable resources, such as alluvial gemstones, narcotic crops, timber, or coltan drive non-separatist rebellious activities in places such as Sierra Leone, Colombia, and Afghanistan, while unlootable resources like diamonds, deep-shaft minerals, oil, and gas are correlated with separatist conflicts. Technology, special expertise and enough capital are required to get revenue from unlootable resources; by contrast, lootable resources can easily be exploited by a small number of unprofessional workers.³⁴ Insurgency groups easily looted the alluvial diamonds in Sierra Leone and Angola due to their simple extraction that did not require sophisticated and expensive technology.³⁵

The different dynamics of lootable and unlootable resource driven conflicts explains the paradox of why diamonds are regarded as a source of wealth in Botswana, but cause conflicts in Sierra Leone. First, Sierra Leone's alluvial diamonds in riverbeds are easily looted by the rebels, whereas Botswana's deep-shaft, kimberlite diamonds necessitate expensive equipment, special expertise, and substantive capital to be mined, which is unattractive to an insurgency. Additionally, the mismanaged and corrupt diamond sector in Sierra Leone by comparison with Botswana's wisely managed diamond mines explains the different outcomes from the same natural resource.³⁶

Additionally, rebel groups earn large sums of money from agricultural products in the regions under their control whether producing themselves or levying high taxes on the locals. The best known example is the cultivation of illegal drugs from which the FARC in Colombia acquired about U.S.\$500 million per year. The mujahedeen in Afghanistan also started to cultivate illegal drugs when they were not able to be funded by the United States. Similarly, in Sierra Leone, insurgent groups fund their activities by imposing taxes on coffee production.³⁷

2. Mismanagement of Natural Resources

A significant number of resource-rich countries suffer from resource curse whether it stems from Dutch disease, rentier states, poor management of resource revenues, or bad political decisions of their leaders. Government mismanagement of

³⁴ Ballentine and Nitzschke, "The Political Economy of Civil War and Conflict Transformation," 6.

³⁵ Collier et al., *Breaking the Conflict Trap*, 90.

³⁶ Ballentine and Nitzschke, "The Political Economy of Civil War and Conflict Transformation," 6.

³⁷ Collier et al., *Breaking the Conflict Trap*, 76.

resource revenues and inequalities in allocation of resource revenues are other factors that trigger civil wars in resource-rich countries.³⁸

Mostly rooted in heavy reliance on resource wealth, many countries have suffered from economic and political underperformance of their governments, weakening their capacity to suppress rebel movements. Lack of diversification in economic activities, large scale corruption, wasteful spending of revenues, and inability to control resource rich regions are some factors that account for the poor economic conditions, and vulnerability to civil war in those countries richly endowed with natural resources.³⁹

Although Nigeria's revenues from rich oil resources have reached about 1.6 trillion dollars since 1980s, they could not prevent a sharp increase in the poverty level. Critical failures in managing the money caused social and political instability which worsened overall economic activities. Iraq and the Democratic Republic of Congo are two other examples of countries suffering from the political and economic underperformance of their governments. The populist policies of rulers, short-term benefit-seeking behaviors and national ambitions resulting in overspending and poor investments are some of the reasons for resource curse. The resultant negative impacts on the economy, political institutions and society in general generate grievances that can promote unrest and conflict.⁴⁰

Lack of diversification in economic activities is one of the most dangerous consequences of resource curse. Easy revenues earned by lucrative natural resources correlate with a country's weak capacity to innovate due to lack of producing industries. Resource-rich countries become more dependent on valuable natural resources and unable to diversify their economic activities, which cause them to fail to innovate. An abundance of lucrative natural resources yielding a large amount of money negatively influences the allotment of money and workers to other economic sectors. High reliance on resource revenues also has significant impact on the development capacity of

³⁸ Lujala et al., "Valuable Natural Resources," 122.

³⁹ Ross, "The Natural Resource Curse," 24–27.

⁴⁰ Lujala et al., "Valuable Natural Resources," 126.

institutions of a given country which then leads to corruption and poor governance of economic activities. Furthermore, resource curse may generate the characteristics of the rentier state, which eventually cause state fragility and high risk of civil conflict.⁴¹

3. Unequal Allocation of Revenues

Greed over sharing the revenues of valuable natural resources creates grievances and insurgency which generally results in further greed and grievances. The unequal allocation of valuable resource revenues increases the greed and grievances of different ethnic or religious groups. Economic inequality can be rooted in both unequal distribution of revenues and unequal ownership of lands.⁴²

Natural resources are not fairly distributed over a country, but in most cases are concentrated in certain areas. The risk of civil war heightens if the locals feel themselves ethnically or religiously different from the rest of the population. The local population may prefer to possess all the revenues for themselves rather than share them with the entire population, which give incentive to secessionist movements. Even they could not secede completely; the rebel organization's relative control in some resource-rich territories could be supported by locals.⁴³

In some cases, rich minority groups desire to secede from the poor majority in order not to bear their burdens anymore. Located in the oil producing region, Aceh people are three times more affluent than their country's average, and they do not want to pay taxes for the poor majority in Indonesia. Zaire, Nigeria and Eritrea suffered from similar secessionist movements initiated by rich minorities living in the resource-rich regions.⁴⁴

⁴¹ Indra de Soysa, "The Resource Curse: Are Civil Wars Are Driven by Rapacity or Paucity?," in Greed and Grievances: Economic Agendas in Civil Wars, ed. Mats Berdal and David M. Malone (Colorado, Lynne Publishers), 138.

⁴² Paul Collier, "Doing Well Out of War: Economic Perspective," in Greed and Grievances: Economic Agendas in Civil Wars, ed. Mats Berdal and David M. Malone, (Colorado, Lynne Publishers), 92.

⁴³ Collier et al., *Breaking the Conflict Trap*, 60.

⁴⁴ Collier, "Economic Causes of Civil Conflict," 206

Even a fair distribution of revenues from valuable natural resources may not prevent conflicts, due to rising expectations. If a resource rich region is deprived of a good amount of revenues, the risk of armed conflict may increase, as in the example of Aceh. Similarly, in Niger, rebel groups complained about the government's exploiting uranium in their region but not distributing the revenues back. The negative effects of the extraction process such as pollution, and population displacements can cause armed conflict. The civil war in Papua New Guinea was started by local residents who were complaining about environmental destructiveness and the unfair distribution of revenues.⁴⁵

4. Eliminating Risk Factors Stemming From Natural Resources

Diversification of economic activity away from dependence on primary commodities, combined with better policies, reduces the risk of civil conflict by lowering the motivations for predation on resources. Diversification of an economy entails technical expertise and technology. The mismanagement of economic activities increases dependence on lucrative natural resources, whereas investing in education and human capital helps on to diversify efforts. Many governments prefer getting high revenues from primary commodity exports rather than investing in diversified economic activities. The international community can encourage and help governments to adopt better economic policies that prompt diversification.⁴⁶

A Government's ability to spend easy revenues from natural resources on public-beneficial programs has an effect on conflict prevention, with respect to the amount of support the government has from the population. People are unsympathetic to rebel activities if they know that their government spends money for their basic needs such as education, health, and infrastructure. Conversely, they are sympathetic to a rebel organization that confronts a corrupted central authority whose top officials are seeking

⁴⁵ Lujala et al., "Valuable Natural Resources," 125

⁴⁶ Indra de Soysa, "The Resource Curse," 127.

personal enrichment. Transparent economic practices in public sector increase governments' popularity and make loot-seeking rebel groups unpopular.⁴⁷

Establishing control mechanisms on the trade of natural resources lessens the opportunity for rebels to acquire large sums of easy money with which to sustain armed conflict. International control and interdiction regimes make it more difficult for insurgency groups to sell the commodities that they loot.⁴⁸ Although these preventive measures can not completely eliminate the rebels' ability to exploit resources, control mechanisms do reduce their prices and shrink the revenues of insurgent groups. The Kimberley Process obstructs rebel groups from trading diamonds in international markets and cuts their revenue sources. The initiative can be a good model for other lootable resources such as timber and oil.⁴⁹

C. POOR ECONOMIC PERFORMANCE OF GOVERNMENTS

Countries whose economies are managed badly for a long period are more susceptible to civil conflicts. Poor economic performance of government is associated with state failure, economic decline, slow growth, low incomes, poverty, and high unemployment rates, all of which weaken the state's capacity to deal with insurgent groups, and increase rebel organization's chances of survival. Figure 2 shows how a small amount of additional growth reduces the risk of conflict in a typical low-income country.⁵⁰

⁴⁷ Collier, "Economic Causes of Civil Conflict," 212

⁴⁸ Ballentine and Nitzschke, "The Political Economy of Civil War," 10.

⁴⁹ Ross, "The Natural Resource Curse," 34.

⁵⁰ Collier et al., *Breaking the Conflict Trap*, 67.

Risk of Civil Conflict

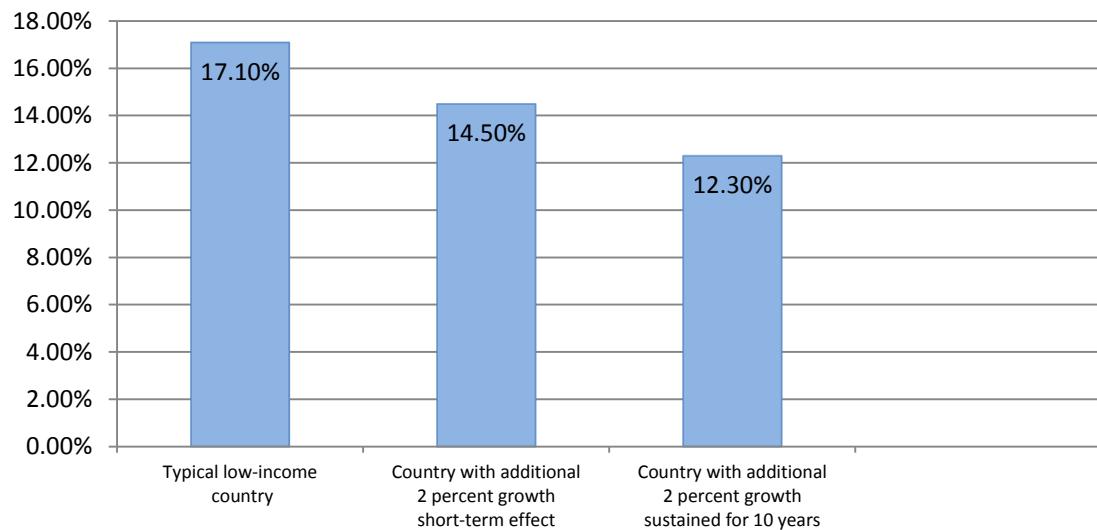


Figure 2. Economic performance and the risk of civil war

Mismanagement of economic activities may also cause grievances which further invite civil conflicts. The economic underperformance of certain governments imposes pain among large numbers of people, and they may be confronted with insurgency from their discontented populations. The National Resistance Movement rebellion in Uganda was largely instigated by the incompetence of successive governments on economic issues.⁵¹

1. Failed States

Social and economic inequality, weak government performance, and an unstable environment are some characteristics of a fragile environment. A fragile environment enables organized crime groups and gangs to evolve into the insurgency groups, motivates ethnically and ideologically different groups to seek retaliation and revenge, and entices rebels, as well as civil and military officials, to benefit from violence.⁵²

⁵¹ Collier, "Doing Well Out of War," 96.

⁵² Robert Muggah, "Stabilising Fragile States and Humanitarian Space," in *Ending Wars, Consolidating Peace: Economic Perspectives*, ed. Mats Berdal and Achim Wennmann, (London: Routledge), 34.

States without legitimate central governments, whose governments are not capable of exerting their authority in some regions of the country, and whose population is deprived of the most basic needs, are named as fragile or failing states. Three types of fragile states create conducive conditions for civil conflicts. If the legitimacy of the central authority is questioned, rebel groups will be emboldened to fill the gap such as in the case of Somalia. If a government has difficulty in controlling some of its territories, insurgent groups will flourish and try to expand their rule, as in Pakistan. If the government is not able to provide basic needs and safety net to its population, insurgent groups will do it by recruiting new rebels and extracting money and resources from them, as has happened in some African countries.⁵³

2. Economic Decline

Conflict is more likely to occur in countries suffering from economic decline. Collier's data suggests that "*each percentage point off the growth rate of per capita income raises the risk of conflict by around one percentage point.*" He also points out how lacking of economic opportunities relates with poor education, and brings higher risk of civil conflict. The rebel organization has an easier task if there are few job opportunities, little schooling, and many young people needing work.⁵⁴ Economic growth encourages people to maintain their lives in compliance with the ruling authority, whereas economic decline may motivate people to rebel against it.⁵⁵

Poverty is not directly correlated with violence or civil conflicts, but is an indication of the lessening capacity of the state to protect and provide basic needs to the people. It is not a coincidence that fifteen of the world's twenty poorest countries have had an intrastate war in the last three decades.⁵⁶

⁵³ John J. Hamre and Gordon R. Sullivan, "Toward Post-Conflict Reconstruction," *The Washington Quarterly*, Autumn 2002, 86.

⁵⁴ Collier, "Economic Causes of Civil Conflict," 206

⁵⁵ Collier, "Doing Well Out of War," 96.

⁵⁶ Johanna Mendelson Forman, "Achieving Socioeconomic Well-Being in Post-Conflict Settings," *The Washington Quarterly*, Autumn 2002, 125–126.

3. Low Incomes and High Unemployment Rates

Low incomes and high unemployment rates increase the risk of civil conflict by facilitating rebel recruitment and lowering the state capacity to eliminate insurgents. First, low incomes and high unemployment directly heighten the proportion of young men willing to be recruited for rebellious purposes.⁵⁷ These two indicators of economic decline also decrease the opportunity cost of joining a rebel organization. Figure 3 shows that the idleness caused mainly by unemployment is the fundamental reason for an individual to join a rebel organization.⁵⁸

Incentives for Joining Rebel Organizations

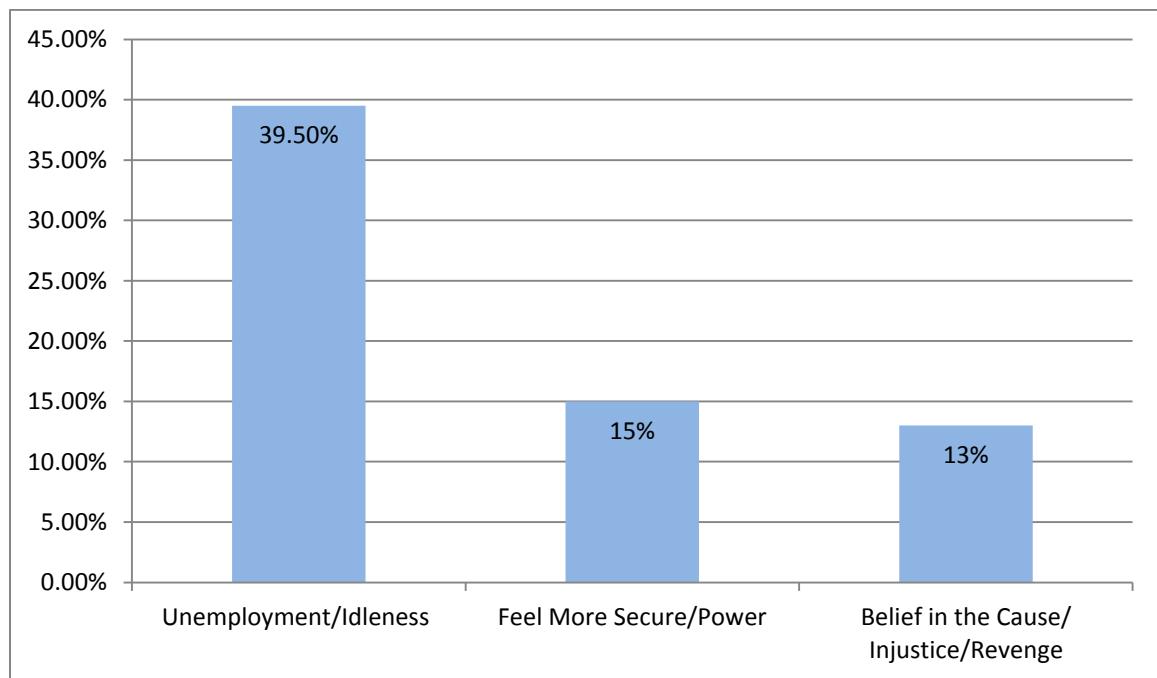


Figure 3. Main incentives for joining a rebel organization.

Low incomes and high unemployment makes rebel recruitment cheap and easy for insurgency groups. Rebellious groups easily recruit hopeless people whose incomes

⁵⁷ Collier, "Doing Well Out of War," 94.

⁵⁸ World Bank, World Development Report 2011: Conflict, Security and Development (Washington, DC: The World Bank, April 2011), 10.

are too low or who do not have a job. For example, in Zaire, the leader of the insurgent groups was able to form an army with only ten thousand dollars with which he aimed to gain control of the state.⁵⁹

Second, the state's capacity to overthrow rebel groups is weakened, due to its inability to finance army and police forces through getting revenues from taxation. Therefore, the government cannot act efficiently to eradicate insurgent organization. Slow economic growth and rapid population growth cause unemployment and decrease salaries both of which make insurgency more likely and help rebel recruitment.⁶⁰

4. Eliminating Risk Factors Stemming From Poor Economic Performance of Governments

Economic growth reduces the risk of civil war through its positive influence on income levels and employment rates. Bannon and Collier introduces "*domestic policies, international aid and access to global markets*" as effective instruments for sustaining economic growth. These three factors reduce reliance on primary commodity exports by diversifying economic activities, strengthening the fragility of economies against volatile prices and market speculations, and ameliorating infrastructure in the country.⁶¹

Ways to reducing the risk factors derived from economic decline and slow growth vary according to countries' characteristics and it is hard to find easy solutions for them. However, it is possible to solve these problems with effective policies. For example, South Korea managed to grow its annual per-capita income from \$300 to \$10000 in a short time. Policy change is not easy in most poor countries because of short-term economic expectations. International aid can be a pushing factor in recovering from decline. In the 1990s, Uganda managed to have a seven percent annual growth rate, with

⁵⁹ Collier, "The Bottom Billion," 21.

⁶⁰ Collier, "Economic Causes of Civil Conflict," 206

⁶¹ Bannon and Collier, "Natural Resources and Violent Conflict," 8–9.

the help of international aid. The economic growth made it more difficult for insurgent groups to find new fighters, which was recruiting rebels for only for \$150 in poor economic conditions.⁶²

D. THE AVAILABILITY OF DIASPORA

1. Diaspora Effect on Funding Violence

Diasporas have a large impact on spurring civil conflicts, both by providing financial support to armed groups, and political support, by lobbying the rebel's cause. Since they are more affluent than people in the country of origin, and are not affected by the abysmal consequences of war, diasporas adherently support armed insurrections.⁶³

Diaspora communities' weight of influence the dynamics of civil wars significantly increased within the international system after the Cold War, due to changes in the nature of war, and globalization.

First, before the Cold War, insurgent movements were dependent on the political and financial support of super powers to initiate and maintain armed struggle. There were many examples of this kind of support in the Cold War. Each superpower supported governments aligned with itself or supported insurgencies that might oust opponent rulers. Since they are deprived of super power patronage in the new international system, armed groups resort to diasporas to fund their military activities.⁶⁴ Similarly, the enemies of a given country may provide financial support insurgency within that country in order to weaken it. Some countries may support rebellion in neighboring countries, which most probably contain clashing internal interests with them, such as in the case of Uganda and Sudan. The Ugandan government funded the rebellious activities of the Sudanese People's Liberation Army; in response, Sudan provided financial support for the insurgency of Lord's Resistance Army in the northern region of Uganda.⁶⁵

⁶² Collier, "Economic Causes of Civil Conflict," 212.

⁶³ Collier et al., *Breaking the Conflict Trap*, 74.

⁶⁴ Joell Demmers, "New Wars And Diasporas: Suggestions For Research And Policy," *Journal of Peace Conflict & Development*, Issue 11, November 2007 , 7. Accessed August 22, 2012. www.peacestudiesjournal.org.uk

⁶⁵ Collier, "Economic Causes of Civil Conflict," 210.

Second, ethnic, religious and cultural sentiments became central themes in the nature of contemporary conflicts. Diasporic communities are inclined to demonstrate their affiliation with groups in the motherland and share their ideals by at least financing their endeavors.⁶⁶ Because they or their ancestors have been the victims of old conflicts, diasporas can have a strong sense of hatred and desire for vengeance towards the ruling authority.⁶⁷

Third, globalization increased the emotional feelings of interconnectedness and social relations through the availability of communicative means and the mobility of people. Diasporic communities are well aware of the social, political and economic situation in their homelands, because of the mass media and Internet. Broadcasts about the discrimination of the ruling authority, their oppressive and brutal policies, and the sufferings of people of origin increased their desire to help.⁶⁸

2. Eliminating Risk Factors Stemming from Diaspora's Funding Grievances

The risks stemming from diasporas can be eliminated by encouraging them to assume responsibilities in the peace-making processes and post-conflict reconstruction missions. According to how they are oriented in civil conflicts; diasporic organizations can assume either a constructive or destructive role in the process. Giving diasporic communities incentives to participate in the peace-process may prevent their funding of violence. They should be informed that the consequences of war are high and that people are suffering much in their homelands. For instance, the Irish-American community funded the civil conflict in Northern Ireland for years. When the peace process began, the diasporas again became the major actor in peace negotiations. Furthermore, diasporic

⁶⁶ Kaldor-Robinson, Joshua, "The Virtual and the Imaginary: The Role of Diasporic New Media in the Construction of a National Identity during the Break-up of Yugoslavia," *Oxford Development Studies* vol. 30, no. 2 (2002), 185.

⁶⁷ Collier, "Economic Causes of Civil Conflict," 210.

⁶⁸ Joshua, "The Virtual and the Imaginary," 185.

communities can provide major capital for the development of their war-torn homelands. Their money, expertise, and business connections are invaluable assets for the economic recovery of their homelands.⁶⁹

⁶⁹ Collier, “Economic Causes of Civil Conflict,” 214

THIS PAGE INTENTIONALLY LEFT BLANK

III. ECONOMIC DIMENSIONS OF PEACE-BUILDING

A. ECONOMIC CHALLENGES IN WAR-TORN COUNTRIES

1. War Economies

A war economy contains all the economic activities performed in wartime conditions. Transforming war economies into peacetime conditions is hard and takes a long time. Jonathan Goodhand divides war economies into three types; combat, shadow and coping economies. These interlinked economies involve different actors with dissimilar motivations using different mediums to implement their economic activities. In addition to predatory and profit seeking concerns, coping and survival are the other considerations that should be taken into account when dealing with war economies.⁷⁰

A combat economy comprises all economic activities to initiate and sustain a conflict. It includes a state's military and police forces, insurgency groups, and conflict entrepreneurs who provide weapons, ammunitions, and military equipment to warring groups. Taxation of both legal and illegal economic activities, such as smuggled goods, opium, or valuable resources; looting and stripping of economic assets, manipulation of aid, economic blockades of dissenting districts, and printing money are some of the activities in a combat economy. Most of the actors in combat economies are contented with the conflict conditions. For most of them, transformation to peacetime would mean loss of wealth and their powerful status. ⁷¹

A shadow economy includes a variety of informal economic interactions out of state regulation and control. Disordered conflict conditions offer opportunities for criminal organizations and businessmen to get high revenues. The black market economy and smuggling in Sierra Leone, Bosnia-Herzegovina and Kosovo are typical shadow economy characteristics.⁷² Profit-seekers benefit from highly liberal economic conditions and lack of a state monitoring and control. Cross-border smuggling of commodities, the

⁷⁰ Jonathan Goodhand, "From War Economy to Peace Economy," 155–157.

⁷¹ Ibid, Table 1, 158.

⁷² Nitzschke and Studdard, "The Legacies of War Economies," 224.

smuggling of high-value commodities, the opium trade, exploitation of natural resources like timber and marble, and aid manipulation are some of the economic activities in shadow economies. Actors in a shadow economy may prefer it to peace if it presents alternatives for investments and legal commercial activities.⁷³ Chaotic wartime conditions enable belligerents to easily deal in shadow economies that serve to sustain a combat economy. The Kosovo Liberation Army financed its armed insurgency with the help of informal economies, such as smuggling and diaspora remittances. Similarly, the rebel groups in Sierra Leone sustained their rebellion with the shadow economy of the diamond industry.⁷⁴

A coping economy encompasses the activities of poor and vulnerable populations. Poor families and communities maintain asset bases through low-risk activities, or to survive through asset erosion. Small businesses, trading, farming, humanitarian assistance and migration of the workforce are some of the key activities in coping economies. The actors in coping economies hope for peace to go beyond subsistence.⁷⁵ Lootable resources are generally a main means of survival in coping economies, for example such as coltan and gold in Democratic Republic of Congo and poppy and coca in Afghanistan and Colombia.⁷⁶

Understanding the social and political aspects of economic activities in wartime are crucial to implementing proper policies for a smooth transformation to peace-time conditions without creating opportunities for insurgent groups to recruit new rebels. Economic activity never stops even in most severe war conditions. A war economy contains all the economic activities performed in wartime conditions. The struggles to adapt these economies into a legal and regulatory framework in a post-conflict environment pose security challenges in the long run.⁷⁷

⁷³ Goodhand, “From War Economy to Peace Economy,” Table 1, 158.

⁷⁴ Ballentine and Nitzschke, “The Political Economy of Civil War,” 9.

⁷⁵ Goodhand, “From War Economy to Peace Economy,” Table 1, 158.

⁷⁶ Ballentine and Nitzschke, “The Political Economy of Civil War,” 9.

⁷⁷ Goodhand, “From War Economy to Peace Economy,” Table 1, 158.

2. Economic Challenges in Peace Negotiations

Peace-makers usually tend to focus on political and military issues in the initial phases of post-conflict stabilization and reconstruction missions, whereas the economic incentives of warring groups and other economic challenges are often relegated to subsequent phases. However, economic issues are one of the main underlying causes of civil conflicts, and achieving durable peace is largely dependent on the economic recovery of a given country. Because a stable economy and development present alternatives to prolonged conflict and instability, they have to be considered as the most important elements in the peace-making process.⁷⁸

The economic dimensions of an ended conflict have serious impacts on the mediation process and the design of a peace agreement. Research shows that the availability of lucrative natural resources and their effect on profit-seekers is a key element in unsuccessful peace-making process. Moreover, if the conflict is terminated without the complete victory of either side, insurgency groups have to be included in the peace process which may require both political and economic arrangements including control over mines, markets and economic and industrial infrastructure.⁷⁹

It is important that combatant groups have some financial expectation about the future. The peace agreement that incorporates positive economic elements for anyone, including loot-seekers, may become an encouraging force in establishing long-lasting peace. As Wennman states:

If armed conflict is really about greed, the only requirement to end a conflict would be show that belligerents can make more money within the bounds of a functioning state, private sector investment and a lasting peace.⁸⁰

Sharing revenues from natural resources is especially important when the allocation of revenues was the main cause of conflict. The optimum distribution of

⁷⁸ Achim Wennmann, “Peace Processes, Business and New Futures after War,” 15.

⁷⁹ Nitzschke and Studdard, “The Legacies of War Economies,” 226, 227.

⁸⁰ Wennmann, “Peace Processes, Business and New Futures after War,” 17.

revenues may have a positive impact on pacifying warring factions and also meet economic goals of development.⁸¹

3. Dealing with Peace Spoilers

The economic agendas of armed groups should be analyzed to achieve a successful transition from civil conflict to peace. Nitzschke and Studdard identify the process as “*a realignment of political interests and a readjustment of economic strategies rather than a clean break from violence to consent, from theft to production, or from repression to democracy.*”⁸² Many transitions from war to peace show that armed groups become reluctant to participate in peace processes if they are benefiting from economic activities in the enduring conflict. Moreover, an expectation to exploiting lucrative resources increases the number of future spoilers.⁸³

Poor security conditions and an abundance of economic opportunities lead to a rise in various armed groups in many post-conflict regions. Criminal groups, violent gangs, drug cartels and other profit-seeking groups create obstacles to stakeholders in post-conflict stabilization and reconstruction. There is a tendency to focus on ex-combatants as responsible for various criminal activities, but newly emerging groups also seek to benefit from economic opportunities in weakly governed post-conflict situations.⁸⁴

Belligerents not only consider criminal activities as valid ways of financing their political purposes, they also see conflict-affected regions as proper territories in which to perform their illegal economic activities. The examples of Afghanistan and Colombia show that civil wars in a particular region eliminates regular financial activities, and creates conditions that all sides of the conflict can benefit from.⁸⁵

⁸¹ Lujala et al., “Valuable Natural Resources,” 131

⁸² Nitzschke and Studdard, “The Legacies of War Economies,” 226.

⁸³ Keen, “Incentives and Disincentives for Violence,” 27.

⁸⁴ Jennifer Hazen, “War Transitions and Armed Groups,” in *Ending Wars, Consolidating Peace: Economic Perspectives*, ed. Mats Berdal and Achim Wennmann (London: Routledge), 158.

⁸⁵ James Cockayne, “Crime, Corruption and Violent Economies,” in *Ending Wars, Consolidating Peace: Economic Perspectives*, ed. Mats Berdal and Achim Wennmann (London: Routledge), 200.

The loot-seeking behavior of combatants during civil conflicts may also create command and control problems that frustrate peace efforts. The opportunistic behavior of combatants can weaken the discipline of belligerents and create agency problems that cause “*sobel*” phenomenon(soldier by day, rebel by night) observed in Angola, Sierra Leone, Burma, Bosnia- Herzegovina and Kosovo.⁸⁶ Combatants comparing their profits in war against the expected benefits of peace may act as spoilers of the peace processes.⁸⁷ For example, Angola’s rebel organization leader hoarded more than \$4 billion from diamond revenues during the first civil conflict. Demobilization efforts for his rebel organization, UNITA, were not successful, because it was almost impossible to offer him more than he expected to gain with prolonging the war.⁸⁸ By contrast, an insurgency organization in Mozambique complied with a relatively small financial package to give up rebellion and transformed itself into a political party due to lack of lucrative resources to influence predatory behavior.⁸⁹

Disarmament, Demobilization, and Reintegration (DDR) is seriously challenged by the predatory behavior of belligerents. Afghanistan, Liberia, the DRC and Sierra Leone demonstrate that armed groups may use their weapons not only for securing themselves, but also for the exploitation of lucrative resources and civilian predation. The continuity of predatory behavior, both from natural resources and other economic activities, has an impact on a combatant’s decision to disarm.⁹⁰

4. Fragile Environment

Conflict-affected countries show the characteristics of state fragility in which the abysmal conditions that caused a civil war are generally deteriorated. In most cases,

⁸⁶ William Reno, “Shadow States and the Political Economy of Civil Wars,” , in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars*” (Boulder: Lynne Rienner Publishers, 2000), 50.

⁸⁷ Ballentine and Nitzschke, “The Political Economy of Civil War,” 15.

⁸⁸ Virginia Gamba and Richard Cornwell, “Arms, Elites, and Resources in the Angolan Civil War,” in Ending Wars, Consolidating Peace: Economic Perspectives, ed. Mats Berdal and Achim Wennmann (London: Routledge), 168.

⁸⁹ Collier, “Economic Causes of Civil Conflict,” 214.

⁹⁰ Ballentine and Nitzschke, “The Political Economy of Civil War,” 15.

governments are not able to provide efficient governance and enough security and hardly meet the basic needs of their people such as providing health, education and other social demands. This fragile environment enables old and emerging armed groups to maintain their criminal activities. These criminal groups pose a threat to the state's capacity to exert power in some parts of the country. They may even substitute for the state by providing security, law and order in some regions.⁹¹

The inefficient management of natural resources and the problem of unfair distribution problem are other important factors that should be dealt with quickly in post-conflict settings. Solving deeply-rooted management problems and transforming corrupt natural-resource industries into well-governed, beneficial economic activities for the whole population are very difficult to accomplish. In Sierra Leone, the Campaign for Just Mining and Kono Peace Diamonds Alliance projects are focused on encouraging locals to be involved in the mining industry. These initiatives aimed at enlarging legal diamond mining, establishing financial transparency and most importantly, providing revenues for artisanal miners and their families.⁹²

5. Informal Economies

Shadow economies are associated with the political economies of many conflict affected areas. Their criminal economic activities weaken post-conflict stabilization and reconstruction efforts. Organized criminal groups in the Balkan civil wars struggled to maintain their control in the economic and political processes in order to consolidate their power in the delicate post-conflict situation. In addition to rebel groups, police and military forces could be involved in criminal economic activities in some of conflict regions. Bosnia, Kosovo, Cambodia, Haiti, and Burma are some examples of where security officials were benefited from informal economies.⁹³

On the other hand, informal economies provide income and livelihoods to a large portion of the civilian population in areas of conflict. These extensive informal economic

⁹¹ Hazen, "War Transitions and Armed Groups," 159.

⁹² Ballentine and Nitzschke, "The Political Economy of Civil War," 16.

⁹³ Nitzschke and Studdard, "The Legacies of War Economies," 229.

activities badly affect the government's ability to collect tax revenues, which then influences the overall post-conflict reconstruction process. Deprived of large revenues, governments have difficulty providing basic goods and services, or even security, let alone implement reconstruction projects and reestablish government institutions.⁹⁴ According to World Bank data, the informal economy accounted for more than fifty percent of GDP in post-conflict Bosnia-Herzegovina. People continued to subsist their lives, but the government could not get tax revenues from these shadow economies. Therefore, the state's capacity to provide security, goods and services depended largely on foreign aids. Similarly, the Kosovo government could only collect half of its potential from public revenues in 2001, due to the illegal activities of informal economies.⁹⁵

B. POLICY OPTIONS FOR COPING WITH THE ECONOMIC CHALLENGES IN A POST-CONFLICT ENVIRONMENT

1. Establishing Global Control Regimes to Curtail Financial Capability of Armed Groups to Resume Violence

Contemporary insurgency activities need to finance themselves to sustain a rebellion. Their ability to get revenues is highly related to their global trading capacity. Decision-makers in the peace-making process may consider curtailing and managing resource flows both regionally and internationally, by implementing control regimes in order to prevent peace-spoilers from having opportunities to start violence again.⁹⁶

Rather than struggling to compel armed groups to compromise or intervening with military force, diminishing a rebellious group's self-financing abilities may yield valuable results. Commodity sanctioning regimes aimed at the predatory exploitation of natural resources, and interdiction regimes targeted at organized crime activities, drug and human trafficking, corruption, and money laundering can be helpful instruments in cutting revenue flows.⁹⁷

⁹⁴ Ballentine and Nitzschke, "The Political Economy of Civil War," 15.

⁹⁵ Nitzschke and Studdard, "The Legacies of War Economies," 229, 230.

⁹⁶ Jonathan M. Viner and Trifin J. Roule, "Follow the Money: The Finance of Illicit Resource Extraction," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions* (Washington D.C.:World Bank Publications,2003), 163.

⁹⁷ Ballentine and Nitzschke, "The Political Economy of Civil War," 11.

Controlling regimes diminish an insurgency group's access to resources by following the progress of natural resources from production to consumption. These tracking systems provide more natural resource revenues to the legal authorities of a country by preventing their illicit exploitation. With the help of well-established commodity-tracking system in Sierra Leone, state revenues from the diamond industry increased from \$2 million a year to \$150 million a year in less than a decade. This example demonstrates not only the very huge revenue that government had been deprived of for decades, but also the important benefit of certification system.⁹⁸

The United Nations Security Council imposed the Kimberley Process Diamond Certification Scheme to reduce the role of the diamond industry in financing civil conflicts in Sierra Leone, Angola, Liberia, and DRC.⁹⁹ The commodity-tracking system was first established in Sierra Leone, in 2003, and provided a significant decline in diamond trading by insurgency groups. The European Union's Forest Law Enforcement, Governance and Trade (FLEGT) scheme is another commodity-tracking system, which aimed to track forest products passing into European Union markets. This timber-licensing system is based on agreements between the EU and the timber-producing countries.¹⁰⁰

On the other hand, the Publish What You Pay Campaign (PWYP) and Extractive Industry Transparency Initiative (EITI) are interdiction control regimes that aim at to prevent corruption and corrosive rent-seeking activities of governments. These regulatory sanctions urge both companies and governments to implement transparency practices. Due to the increased influence of international criminal networks, conflict trade and diaspora remittances in maintaining civil wars, sanctions and interdiction policies should be taken into consideration in the peace-making process.¹⁰¹ Transparency and accountability policies are based on the idea that if a population is aware of their resources' production and trading process, they can hold their rulers responsible about

⁹⁸ Lujala et al., "Valuable Natural Resources," 129

⁹⁹ Ballentine and Nitzschke, "The Political Economy of Civil War," 13

¹⁰⁰ Lujala et al., "Valuable Natural Resources," 130

¹⁰¹ Ballentine and Nitzschke, "The Political Economy of Civil War," 13

their mismanagement and corruption. These mechanisms inspect both expenditures of resource revenues and resource contracts.¹⁰²

2. Alleviating Socioeconomic Problems

Achieving socio-economic well-being is one of the most formidable tasks in post-conflict reconstruction mission. Providing basic needs to refugees and displaced persons only is not the proper way to address the problem. Almost all citizens may require basic human needs like food and shelter. Additionally, the peace-builder should provide health facilities, educational systems and a socially secure environment in order to effectively address initial socio-economic problems in conflict-affected societies.¹⁰³

In some cases, peacemakers may consider tolerating criminal activities in the post-conflict environment, such as poppy production in some parts of the Afghanistan. Similarly, illegal arms and food smuggling in Bosnia played a constructive role in the conflict years, both balancing the military power of a violent opponent and providing for the social needs of the population in conflict-affected areas.¹⁰⁴

The allocation of profits between state and producing regions is also an important issue and may facilitate to reach productive results in negotiations, as happened in South Sudan, Aceh, and Papua New Guinea. The revenue allocation figures varies significantly according to the different characteristics of these countries. Oil-producing regions in Nigeria receive only thirteen percent of revenues generated by oil whereas Aceh in Indonesia receives seventy percent and South Sudan receives fifty percent of the revenues from the produced oil in their regions. Governments should establish a balanced revenue allocation system that allows development of whole country without offending producing regions.¹⁰⁵

¹⁰² Viner and Roule, “Follow the Money,” 180–183.

¹⁰³ Forman, “Achieving Socioeconomic Well-Being in Post-Conflict Settings,” 126.

¹⁰⁴ Cockayne, “Crime, Corruption and Violent Economies,” 212.

¹⁰⁵ Lujala et al., “Valuable Natural Resources,” 132.

Subsequent socio-economic efforts should direct to improvement of physical infrastructure, creating employment opportunities, establishing legal regulatory framework, forming financial institutions, providing conditions for international trade and investments.¹⁰⁶

3. Building New Economic Institutions

The poor governance of natural resources is one of the main causes of civil conflicts in many resource-dependent countries. Resource and development relation largely depends on quality of governance and efficient management of resources. As Phillippe Le Billon states: *“Unsurprisingly, badly governed countries with poor populations living in areas with easily lootable resources are among the most challenging contexts.”*¹⁰⁷ For example, in Nigeria, resource revenues are absorbed by corrupt national and local officials, so that no money remains for the development of Niger delta. Likewise, in Myanmar, large amounts of revenue were spent to consolidate government power by increasing the military capacity of their rule. The international community’s efforts to help governments reform are generally unsuccessful, due to the central authority’s concerns about diminishing power.¹⁰⁸

Given the fact that the political economies of civil conflicts are very localized, reforms should subsume local-level stakeholders as well as provincial and municipal actors. Institutions should intervene at the micro level; individuals, households, and small communities, and macro level; warlords, tribal and religious authorities and criminal leaders.¹⁰⁹

Coping with these challenges necessitates efficient management strategies for natural resources. Only robust national and local institutions can provide efficient management of resources and revenues. Most importantly, establishing a legal regulatory

¹⁰⁶ Forman, “Achieving Socioeconomic Well-Being in Post-Conflict Settings,” 126.

¹⁰⁷ Lujala, Rustad and Le Billon, “Valuable Natural Resources, 134.

¹⁰⁸ Ibid., 135.

¹⁰⁹ Cockayne, “Crime, Corruption and Violent Economies,” 210.

framework to supervise property rights, negotiate and execute contracts, and administer taxation allows management of resources free from corruption.¹¹⁰

Liberia is a good example of sector-institution building. The forest sector reform process clearly exposed the widespread corruption and poor economic governance of the Liberian forests. Reformers managed to improve productivity and eradicate corruption and fraud by implementing efficient policies on staff training, reorganizing the sector, and better evaluating the size of labor.¹¹¹

Furthermore, establishing economic institutions has a crucial impact on eliminating criminal economies. Realistic microeconomic and macroeconomic development schemes create alternatives to criminal economies. DDR programs cannot persuade rebels to lay down their arms without giving them economic incentives. For example in southern Afghanistan, a Taliban fighter has very few alternatives other than poppy production on which he and his family can subsist. Without establishing institutional reform, it is unwise to expect Taliban fighters to give up their arms and integrate themselves in legal economic activities.¹¹²

4. New Visions for Future

A post-conflict reconstruction mission should address the legacies of ethnic conflicts by building political institutions and providing economical social development. Building credible and robust institutions, generating self-sustaining economic growth and creating civil society and civic organizations enable people to forget their pasts and live peacefully again. As Wolff states:

The essential aim of post-conflict reconstruction is to create a set of political, economic, and social structures in accordance with an agreed conflict settlement that allows the conduct of a non-violent, just, and

¹¹⁰ Lujala, Rustad and Le Billon, “Valuable Natural Resources, 134.

¹¹¹ Ibid., 136.

¹¹² Cockayne, “Crime, Corruption and Violent Economies,” 209.

democratic political process in which incentives for peaceful political strategies outweigh any potential benefits to be gained from a return to violence.¹¹³

Peace-building efforts should focus on giving positive economic incentives to criminal organizations. Creating better prospects with economic development assists in transforming them to legitimate economic actors. If these organizations view their criminal activities as more profitable, they may decide to continue these activities in peace-time.¹¹⁴ As Wennmann states:

If armed conflict is really about greed, the only requirement to end a conflict would be to show that belligerents can make more money within the bounds of a functioning state, private sector and a lasting peace.¹¹⁵

However, it is difficult to distinguish when criminal armed groups will be opponents and when they become partners in the peace process.¹¹⁶

¹¹³ Stefan Wolff, *Ethnic Conflict: A Global Perspective*, (Oxford University Press), 175.

¹¹⁴ Cockayne, “Crime, Corruption and Violent Economies,” 204.

¹¹⁵ Wennmann, “Peace Processes, Business and New Futures after War,” 17.

¹¹⁶ Cockayne, “Crime, Corruption and Violent Economies,” 205.

IV. CASE STUDY: KOSOVO

A. INTRODUCTION

Examination of the outbreak and evolution of the civil war in Kosovo demonstrates that economic variables, rather than social elements, have a significant impact on the course of civil conflicts, even in an ethnically and religiously divided country.¹¹⁷ The economic characteristics of a given country and insurgent groups' opportunities to sustain their rebellion there require incorporating economic perspectives in the analysis of civil conflicts. Social grievances, which can be rooted in ancient hatreds, inequality, a lack of democracy, and ethnic and religious divisions are useful media for the leaders of the insurgent groups to use to legitimize their actions and gather dissatisfied people under a common cause; but they cannot provide money and resources for the expensive undertaking of fighting against state forces.¹¹⁸

Peaceful protest movements against the oppressive Milosevic regime turned into a military struggle only after Kosovar Albanians became financially capable of confronting the government forces in a prolonged conflict. The occurrence of civil conflict is related to an insurgent group's ability to maintain their military activities against central authority. Initiating a war against a central authority requires at least forming a military organization with a group of people, and providing equipment, weapons and ammunitions to them in continually.¹¹⁹ Although religious and national sentiments, socio-economic inequalities, and neighborhood spillover effects had impacts on Kosovar Albanians' struggle for independence from Yugoslavia, economic factors, such as enduring economic decline, high unemployment, low incomes, and the availability of an Albanian diaspora made it feasible for the Kosovo Liberation Army to maintain an insurgency against Serbian authorities.¹²⁰

¹¹⁷ Alexandros Yannis, "Kosovo: The Political Economy of Conflict and Peacebuilding," in Karen Ballentine & Jake Sherman(eds.), *The Political Economy of Armed Conflict, Beyond Greed & Grievance* (Colorado: Lynne Rienner Publishers,2003), 168.

¹¹⁸ Paul Collier, "Economic Causes of Civil Conflict," 197.

¹¹⁹ Ian Bannon and Paul Collier, "Natural Resources and Violent Conflict," 3.

¹²⁰ Yannis, Kosovo: The Political Economy of Conflict and Peacebuilding, 172.

The economic recovery of Kosovo necessitated coping with challenges from the post-conflict transition, and post-socialist and post-secession transitions.¹²¹ First, the civil war and NATO's air bombardment devastated the country and an already crippled economic situation was made worse. Infrastructure was badly damaged, houses were destroyed, burned or looted, and agricultural activity almost stopped because of the displacement of hundreds of thousands of persons and the large scale use of land mines.¹²² Second, a volatile security environment and political uncertainty hindered post-conflict economic recovery for years, with their negative effects on direct investments and entrepreneurship. Third, harnessing informal economies and dealing with potential peace spoilers was the main challenge for peace-makers in the aftermath of the conflict. The members of the KLA emerged as the new political and economic actors during the conflict years. These new elites did not want to lose their status, power, and wealth after the conflict was over.¹²³ Fourth, the transition to a free-market economy from a centrally planned socialist model with the absence of economic institutions, a legal regulatory framework and human capital hampered economic development in the first years of the post-conflict economic recovery mission.¹²⁴

The international community focused mainly on the economic reconstruction of the country to achieve short-term success, whereas endorsing economic reforms to build robust economic institutions was largely neglected, which had negative repercussions in long-term economic development.¹²⁵ Economic reconstruction efforts, like providing humanitarian aid, food, and other basic needs, building roads, bridges, water irrigation systems, and telecommunication systems were needed in the initial stages of post-conflict

¹²¹ Graciana del Castillo, *Rebuilding War-Torn States: The Challenge of Post-Conflict Economic Reconstruction*, Oxford University Press, 2008, 139-140.

¹²²Patrice C. McMahon and Jon Western, “Out of Sight, Out of Mind: Post-Conflict Economic Planning in the Balkans” in *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics* (Kauffman Foundation and Command and General Staff College Foundation),2010, 80.

¹²³ Castillo, *Rebuilding War-Torn States*,144-145.

¹²⁴ James McGinn Dobbins and Keith John G. Crane, *America's Role in Nation Building: From Germany to Iraq* (Santa Monica: RAND Corporation, 2003), 113.

¹²⁵ McMahon and Western, “Post-Conflict Economic Planning in the Balkans,” 85.

recovery to create a good image and prevent social unrest; but prolonged old policies for a protracted period, hindering economic development by undermining small businesses, local farmers and merchants.¹²⁶

B. COUNTRY PROFILE AND HISTORICAL BACKGROUND

1. Country Profile

Kosovo is situated in the Balkans. It is bordered by Serbia, Montenegro, Macedonia and Albania. According to an April 2011 census, the population of the country is 1.7 million. 88% of the population is ethnic Albanians, 7% ethnic Serbs, 5% other communities (Bosniak, Gorani, Roma, Ashkali, Egyptian, Turkish). The six stars on the flag represent the ethnic communities in the country. The majority ethnic Albanian population, as well as the Bosniak, Gorani, and Turkish communities, and some of the Roma/Ashkalia/Egyptian communities are Muslims that account for 91 percent of the population. The ethnic Serb population is largely Serbian Orthodox. Approximately 3% of ethnic Albanians are Roman Catholic. Albanian and Serbian are the official languages; Bosnian and Turkish are official only in some municipalities where significant numbers of these minorities reside. The adult literacy rate is about 92 percent.¹²⁷

Although Kosovo had significant political and economic troubles, it aimed to reach democracy and European type government style since unilaterally declaring independence in February 2008. However, as the poorest economy in Europe, it suffers a 45 percent officially unemployment rate. As Figure 4 shows, poverty and extreme poverty rates are high both in urban and rural areas.¹²⁸ The per capita GDP is about 2,600 euros.¹²⁹ Poor infrastructure, and political and legal uncertainties have resulted in limited foreign direct investment. The economy is dependent on the service sector, international

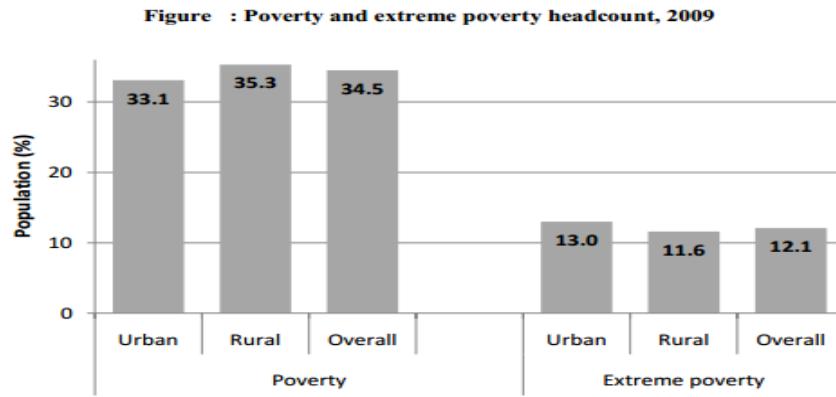
¹²⁶ Nicholas H. Riegg, “Implementing Expeditionary and Entrepreneurial Economics: Iraq and Afghanistan” in *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics* (Kauffman Foundation and Command and General Staff College Foundation), 165.

¹²⁷ Kosovo Information Page, State Department website, <http://www.state.gov/p/eur/ci/kv/>.

¹²⁸ World Bank, Consumption Poverty in the Republic of Kosovo in 2009, May 2011, 4. Accessed August 22, 2012.
http://siteresources.worldbank.org/INTKOSOVO/Resources/Kosovo_Poverty_for_web_eng.pdf.

¹²⁹ World Bank, The World Bank in Kosovo, Program Snapshot, April 2012, 1–5.

aid and remittances from the Kosovar Albanian diaspora in Europe. Remittance inflows to Kosovo amounted to 11 percent of GDP in 2009. Services make up 65 percent of the total GDP.¹³⁰



Source: World Bank staff estimates based on 2009 HBS.

Figure 4. Kosovo, poverty and extreme poverty headcount, 2009.

2. Historical Background

Kosovo was an autonomous region in the Socialist Federal Republic of Yugoslavia (SFRY). Under the rule of Tito, Yugoslavia had a socialist economy with state ownership and centralized economic planning. In this socialist model, Kosovo was the most underdeveloped region of the country whose centrally planned economy was based on state-owned industries like; heavy manufacturing, agriculture and mining.¹³¹

In the 1980s, Yugoslavia suffered from important economic problems, which badly affected the Kosovars. The unemployment rate reached a peak of 58 percent in 1988; similarly inflation rose to almost 1,200 percent in the same year. Milosevic's revoking Kosovo's autonomous status and dissolving the Kosovo parliament deteriorated the economic situation. As a consequence of political pressure, economic activities in the region diminished about 50 percent in 1989. Moreover, many ethnic Albanian state employees were replaced by Serbs in the region. Many Kosovo Albanians had to move to

¹³⁰ Kosovo Information Page, State Department website.

¹³¹ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 80.

European countries where they formed a strong Albanian diaspora.¹³² As a reaction to Belgrad's political, social and economic pressures, Kosovo Albanian began a peaceful resistance movement in the early 1990s, led by Ibrahim Rugova. They established a parallel government funded mainly by the Albanian diaspora remittances and informal economic activities. The nonviolent movement eventually turned into armed resistance in the form of the Kosovo Liberation Army (KLA).¹³³

Belgrade's response was harsh against secessionist movements in the region. Counter-insurgency operations turned into an ethnic-cleansing campaign against Kosovar Albanians. More than 45 percent of the population had to flee the country. American-led NATO forces intervened in March 1999. The UN established the UN Interim Administration Mission in Kosovo (UNMIK), under the control of a Special Representative of the Secretary General (SRSG). In 2001, UNMIK promulgated a constitutional framework that provided for the establishment of Provisional Institutions of Self-Government (PISG). After long diplomacy, Kosovo declared its independence from Serbia on February 17, 2008.¹³⁴

C. ECONOMIC CAUSES OF THE KOSOVO WAR

Peaceful protest movements against the oppressive Milosevic regime turned into a military struggle only after Kosovar Albanians became financially capable of engaging government forces in a prolonged conflict. The occurrence of civil conflict is related with an insurgent group's ability to maintain their military activities against a central authority. Initiating a war against a central authority requires at least forming a military organization with a group of people, and providing equipment, weapons and ammunitions to them in a continuous manner.¹³⁵ Although religious and national sentiments, socio-economic inequalities as well as neighborhood spillover effects have impacts on Kosovar Albanian's struggle for gaining independence from Yugoslavia, economic factors, such as enduring economic decline, high unemployment, low incomes,

¹³² Castillo, *Rebuilding War-Torn States*, 137-138.

¹³³ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 111.

¹³⁴ Castillo, *Rebuilding War-Torn States*, 140.

¹³⁵ Bannon and Collier, "Natural Resources and Violent Conflict," 3.

and the availability of Albanian diaspora made it possible for KLA to maintain an insurgency against Serbian authorities.¹³⁶

1. Low Incomes and a High Unemployment Rate

The KLA could easily recruit thousands of idle young men due to low incomes and a high unemployment rate. These two indicators of economic decline decrease the opportunity cost of joining a rebel organization. Rebellious groups easily recruit hopeless people whose incomes are too low or who do not have a job. The research shows that idleness caused mainly by unemployment is the fundamental reason for an individual to join a rebel organization or gang.¹³⁷

Kosovo was the most underdeveloped region in Yugoslavia. Due to highly centralized economic policies, 60 percent of economic activities was based on agricultural. The Milosevic regime's discriminatory policies deteriorated economic conditions further with shrinking the economic activities about 50 percent. Many Kosovar Albanians had to immigrate to Europe in order to earn a living for their families. Brain drain was another direct consequence of the abysmal economic conditions in the region.¹³⁸ Although it is not possible to obtain exact economic figures for Kosovo under Yugoslavian rule, the estimated unemployment rate reached about 60 percent in the same years. It became easy and cheap for the KLA to recruit new members to fight the Serbian authorities.¹³⁹

2. The Diaspora

Kosovar Albanian diaspora remittances played a major role in sustaining the rebellious activities throughout the civil war. Many Kosovar Albanians had to leave their country, due to the Milosevic regime's oppressive policies and economic inequalities in

¹³⁶ Yannis, Kosovo: The Political Economy of Conflict and Peacebuilding, 175–176 .

¹³⁷ World Bank, Security Development Report, Part 2 Vulnerability to Violence,78.

¹³⁸ Castillo, *Rebuilding War-Torn States*, 138.

¹³⁹ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 80.

Kosovo. Many of them had a strong sense of hatred and desire for retribution against Serbian rule. They had more extreme views than the people in Kosovo about gaining independence by means of fighting.¹⁴⁰

At the beginning of the 1990s, the diaspora communities Rugova's non-violent resistance by funding the parallel governance of the Democratic League of Kosovo; however, neighborhood effects of the Dayton Agreement and the crisis in Albania changed the flow of money from Rugova's party to the KLA. After the Dayton Agreement, many diaspora communities believed that the KLA's armed insurgency rather than Rugova's peaceful resistance movement was a feasible option to achieve Kosovar secession from Serbia. Furthermore, the crisis in Albania increased the military power of KLA members by enabling them to procure large numbers of weapons and military equipment very cheaply. The KLA's gaining power and influence in the homeland increased its popularity among the outside Albanian population, which aggrandized its share of the remittances.¹⁴¹

3. Neighborhood Effects

The implications of the Dayton Accord, the crisis in neighboring Albania, and the Milosevic regime's weak position in domestic and international affairs accelerated the transformation of Rugova's peaceful protest movement into rebellion against the Serbian state. To begin with, Kosovar Albanians' expectations of independence from Serbian rule increased with Bosnia and Herzegovina's secession from Yugoslavia under the terms of Dayton Accord. Next, the chaos in Albania of 1999 enabled the KLA to provide weapons, ammunitions and military equipment from neighboring Albania to use against the central authority.¹⁴² Next, the Milosevic regime was politically, economically, and psychologically weakened, due to secessionist movements throughout the old Yugoslavian state, and costly war with Croatia and Bosnia. The atrocities they committed in the Bosnian War put them in a very weak position in the international community.

¹⁴⁰ Collier et al., *Breaking the Conflict Trap*, 74–75.

¹⁴¹ Yannis, "Kosovo: The Political Economy of Conflict and Peacebuilding," 174.

¹⁴² Castillo, *Rebuilding War-Torn States*, 138.

Despite their determination to keep remaining territories united, there was a big pressure on the international community to intervene against Serbian brutality when the fighting was intensified.¹⁴³

D. CHALLENGES FOR ECONOMIC RECOVERY

UNMIK and KFOR took over the responsibility for stabilization and reconstruction of post-conflict Kosovo with the enactment of UN Security Council 1244 of June 10, 1999. The resolution replaced Serbian security and administrative authorities with the international officials who authorized the presence of a NATO-led peace-keeping force and UN interim administration.¹⁴⁴

The international community had a hard task for Kosovo's reconstruction since it had to deal with not only post-conflict transition but also post-socialist and post-secession transitions. The international community had several economic challenges to cope with when they assumed the responsibility of the economic reconstruction of Kosovo: the devastation of war and a fragile environment, the transition to a market economy, and elimination of informal economies were some of the most important ones.¹⁴⁵

1. The Devastation of War, Volatile Security Environment and Political Uncertainty

The devastation of war, a volatile security environment and political uncertainty were the first major obstacles for post-conflict economic recovery efforts with their negative effects on direct investments and entrepreneurship activities.

First, the civil war and NATO's subsequent air bombardment devastated the country and made a crippled economic situation worse. Infrastructure was badly damaged, houses were destroyed, burned, or looted, and agriculture almost stopped because of the displacement of the population and large scale use of land mines.¹⁴⁶

¹⁴³ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 111.

¹⁴⁴ Yannis, "Kosovo: The Political Economy of Conflict and Peacebuilding," 179.

¹⁴⁵ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 76.

¹⁴⁶ Ibid., 80.

Second, the volatile security environment frustrated economic reconstruction and development efforts since establishing a safe and secure environment was UNMIK's primary focus. The risk of retributive violence was very high, since withdrawing Serbian forces and KLA militants were both seeking revenge. Although the deployment of KFOR and UNMIK's taking responsibility of administration in the country enabled almost one million Kosovar Albanians to return to their homes, their presence could not prevent Serbian minorities from displacing to Serbia or to Serbian enclaves within the boundaries of Kosovo, with the fear of retribution from returning Albanian population.¹⁴⁷

Third, the undetermined status of the country hindered investments and entrepreneurship activities in the region for years. Due to its inability to borrow money, Kosovo depended on foreign assistance from donor countries and organizations to finance its nascent economy. Although the new country benefited from some projects, such as the “quick impact trust fund” to meet the basic needs of local communities, political uncertainty frustrated self-financing programs aimed at sustaining economic development.¹⁴⁸

2. Transition to Market Economy

Before the war, the Kosovar economy was a small part of the Yugoslavian economic structure. Most of the economic activities in the region were centrally planned and administered by political and financial authorities in Belgrade. The economy depended on state-owned enterprises that ceased to run with the beginning of the conflicts, and the economic infrastructure was very weak. National decision makers, as well as the population, were unfamiliar with the free-market economy. The transition process to a peace-time economy in a free-market model should be supported by new legal regulatory frameworks and institutions. Especially, the laws should address the complex problems of property rights.¹⁴⁹

¹⁴⁷ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 113.

¹⁴⁸ Castillo, *Rebuilding War-Torn States*, 145-146.

¹⁴⁹ McMahon and Western, “Post-Conflict Economic Planning in the Balkans,” 81.

Furthermore, the removal of experienced Serbians from industries caused a shortage of skilled personnel to assist the UNMIK in running economic activities. Although, Kosovar Albanians were removed from administrative duties for decades in the Milosevic regime, these inexperienced personnel were the only human capital that could be used to jump-start the economy.¹⁵⁰

3. Property Rights

Property rights issue were another big challenge for the international community in the initial years of reconstruction. UNMIK regulated residential and commercial property rights, but structuring state-owned enterprises and trying to privatize them was not easy because of political ambiguity. For example, UNMIK tried to re-operate the Trepca Mining and Metallurgical Complex with the help of foreign investments. This initiative would provide about 2000 jobs for locals, but both Serbian and Albanian people prevent it with their protests. Privatization meant to them the exploitation of their valuable resources by foreigners. Disregarding complicated problems of property rights had negative impacts on long-term investment policies, and created pessimism about economic recovery.¹⁵¹

4. Informal Economies

Civil war created new political and economic actors who wanted to maintain their wealth and power after NATO's intervention. Before and during the conflict, KLA captured almost all the economic activities of the region. They established their own political and financial power. They do not want to lose their benefits in the post-conflict environment.¹⁵²

Decades of poverty and socio-economic discrimination of Belgrade's regime impelled Kosovar Albanians to seek alternative sources for economic survival. The discriminative legislations in 1990s caused almost 145.000 ethnic Albanians to lose their

¹⁵⁰ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 113.

¹⁵¹ Castillo, *Rebuilding War-Torn States*, 153.

¹⁵² Ibid., 144-145.

jobs. The youth unemployment rate reached 70 percent in 1995. Diaspora remittances enabled most of families to subsist but many people were involved in informal economic activities to meet basic needs. Furthermore, Rugovo's parallel government was reliant on the revenues obtained from informal economies. KLA's increased power in the country also intensified informal economic activities in the region.¹⁵³

The presence of KFOR and UNMIK did not stop the illegal activities of criminal economic organization that dramatically decrease the revenues from taxation. Informal economies became more widespread after the withdrawal of Yugoslavian military and police force. According to UNMIK report in 2001, the interim administration was not able to collect half of the potential tax revenues, due to the activities of informal or criminal organizations. Soon after the departure of Serbian authorities, the KLA captured important economic assets, such as real estate, hotels, and petrol stations. These economic resources not only provided a large amount of money for KLA to become a political power, but they were also used for money laundering operations.¹⁵⁴

The parallel political structures of both Serbian and Albanian sides also challenged the rule of central authority through taxation of economic activities in their regions. The local elites benefited from power vacuum for the purpose of self-enrichment and gaining political influence. The illegal taxation, extortion and criminal economies became a part of post-conflict economic environment. UNMIK's and KFOR's inability to stop these illegal activities weakened their credibility among population.¹⁵⁵

5. Coordinating Post-Conflict Reconstruction Efforts

Coordinating and integrating efforts of many organizations which have different structures, priorities and budgets posed many challenges to UNMIK, especially at the early phases of the reconstruction process. As mandated by UNSCR 1244, UN assumed the leadership role in harmonizing the efforts of organizations like; NATO, EU, OSCE and many agencies within UN such as UNHCR. Each organization took the responsibility

¹⁵³ Yannis, "Kosovo: The Political Economy of Conflict and Peacebuilding," 173–174.

¹⁵⁴ Ibid., 181.

¹⁵⁵ Castillo, *Rebuilding War-Torn States*, 148.

of specific duties for Kosovo's civil and economic reconstruction. EU assumed the leadership for economic reconstruction and development, UNHCR was assigned for humanitarian issues, and OSCE was focused on democratization process.¹⁵⁶ UNMIK neither had designed economic recovery strategy for an integrated operation nor it had managerial and executive capabilities to implement it. UN unpreparedness in establishing a cooperative mechanism among these essentially different institutions, and setting priorities in an integrated way to achieve common goal of reconstruction scaled down the economic recovery achievements.¹⁵⁷

E. POST-CONFLICT ECONOMIC RECOVERY EFFORTS

1. International Priorities

The European Union assumed the responsibility of the economic reconstruction task. To coordinate international assistance and development activities, it cooperated with the World Bank, the United States and other international donors. The international community's efforts were strong and unprecedented which mainly accounted for some achievements in the region.¹⁵⁸ For example, EU-World Bank report in 2000 estimated that at least \$2.3 billion was needed for the reconstruction job till to the 2004. The international community provided about 3 billion dollars to this assessment. However, international community was not successful enough to differentiate between economic reconstruction and development. They acknowledged the importance of supporting small businesses, but they could not endorse the necessary reforms to build economic institutions. The role of economic development was not in the international community's planning and first priorities; the main focus was on economic reconstruction.¹⁵⁹

The reconstruction of Kosovo's economy were needed in the initial stages of the post-conflict recovery mission for good image and for preventing social unrest, but prolonging the same policies did not yield sustainable economic development. On the

¹⁵⁶ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 115.

¹⁵⁷ Castillo, *Rebuilding War-Torn States*, 144-145.

¹⁵⁸ Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 125

¹⁵⁹ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 85.

other hand, economic development focuses more on entrepreneurial activities, which would help in establishing new firms, creating jobs for people and eventually achieving sustainable growth in the long run.¹⁶⁰

2. Post-Conflict Economic Recovery Policies

International efforts were quick and successful in providing security and humanitarian assistance to war-torn Kosovo. Most of the Kosovar Albanian refugees and IDPs returned their homes within the first month of the intervention as a result of KFOR's ability to minimize security threats. UNMIK was quite successful in meeting the basic needs of food assistance to almost 900, 000 persons, and emergency shelter for thousands of people during the intervention year.¹⁶¹

Being the main responsible organization for economic reconstruction the EU started to institution building efforts soon after emergency humanitarian relief tasks were done. A Central Fiscal Authority (CFA) was established to regulate import tariffs, and to determine tax policies and budget formulation. The authority assumed the responsibility of finance ministry until the real ministry was formed.¹⁶² Financial transactions were put in a regulatory framework with the creation of Banking and Payments Authority of Kosovo (BPAK). BPAK not only supervised local financial institutions as a central bank, but also organized the payment system.¹⁶³ The complicated old trade regime was substituted with the simple 10 percent tariff rate system. Additionally, foreign currencies were accepted in domestic transactions that facilitated tax collection.¹⁶⁴

The international community found a surprisingly dynamic small business environment in Kosovo which assisted the progress of economic reconstruction and development. Yugoslavia's central authorities had full control of economic activities in

¹⁶⁰ Carl Schramm, "Expeditionary Economics: Spurring Growth after Conflicts and Disasters," *Foreign Affairs* (May/June, 2010), 91.

¹⁶¹ Dimitri G. Demekas, Johannes Herderschee, and Davina F. Jacobs, *Kosovo: Progress in Institution Building and Economic Policy Challenges* (Washington, D.C.: International Monetary Fund, December 6, 2001), 2.

¹⁶² Dobbins and Crane, *America's Role in Nation Building: From Germany to Iraq*, 123.

¹⁶³ Demekas et al., *Kosovo: Progress in Institution Building*, 3.

¹⁶⁴ *Ibid.*, 2.

the economic recession in 1980s and 1990s, prompted many people to create their own small businesses which were mostly created by the financial assistance of diaspora in Europe. Badly affected by the war, these small businesses were supported with the establishment of the Kosovo Micro Enterprise Bank (MEB Kosovo) in 1999. Besides providing banking services, the bank gave loans to between 18,000 and 20,000 microenterprises and small- and medium-size enterprises (SMEs). Legalizing informal economies was relatively successful in comparison to privatization efforts. Controlling illicit economic activities provided a good amount of money for the government.¹⁶⁵ However, the international community's interest and generosity began to decline after three years of involvement, mostly due to uncertainties about Kosovo's final status. Long-term economic development strategies were replaced by short-term political decisions.¹⁶⁶ Because of the decline in foreign assistance, the investment rate was diminished from 40 percent of the GDP level to 31 percent of the GDP in the period of 2001–2006.¹⁶⁷

Kosovo's undetermined final status had negative impacts on many economic issues, such as property rights, foreign direct investments, and unemployment. Macroeconomic policies could not be implemented successfully, and Kosovo was deprived of the economic advantages of being a member of an international organization. The inability to cope with these challenges made Kosovar economy largely reliant on donor countries' financing aid and diaspora remittances.¹⁶⁸

The unilateral declaration of independence gave positive incentives to foreign investments and employment creation by increasing the predictability of the economy, and put property rights into a legal and regulatory framework to some extent, but Serbia's refusal to recognize the secession of Kosovo, as well as Russia's strong support for Serbia, and many other countries' abstention, prevented an economic boom which was

¹⁶⁵ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 85–86.

¹⁶⁶ Ibid., 87.

¹⁶⁷ USAID, *Kosovo Economic Performance Assessment*, May 2008, 30. http://pdf.usaid.gov/pdf_docs/PNADL767.pdf Accessed August 22, 2012.

¹⁶⁸ McMahon and Western, "Post-Conflict Economic Planning in the Balkans," 86.

expected to happen right after the declaration of independence.¹⁶⁹ The economic performance of the country had been poor for years. As Figure 3, 4, and 5 demonstrate; unemployment and GDP rates remained unchanged. Revenues did not increase much.¹⁷⁰

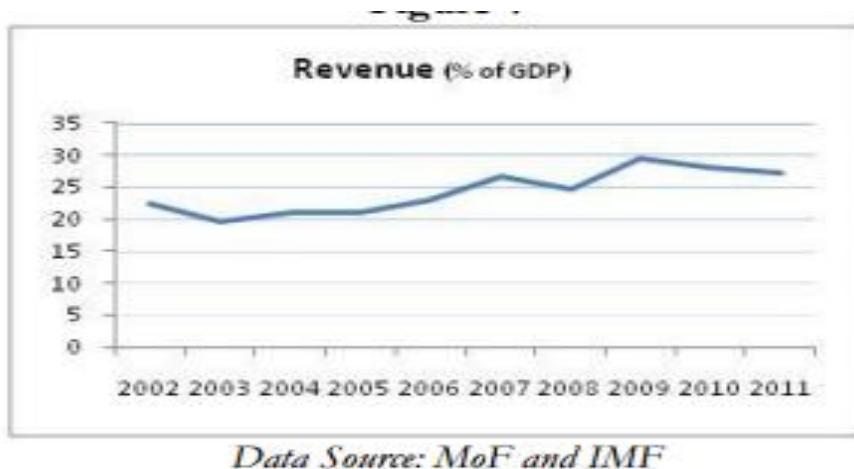


Figure 5. Kosovo, revenue (% of GDP) between years 2002–11.

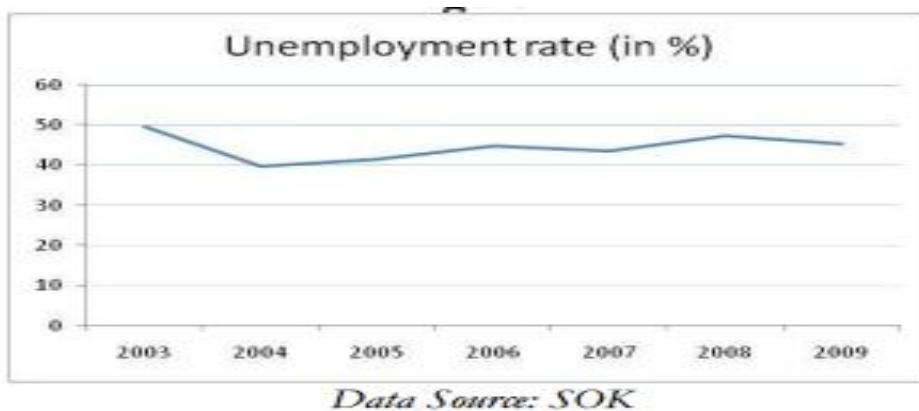


Figure 6. Kosovo, unemployment rate (in %) between 2003–10.

¹⁶⁹ Castillo, *Rebuilding War-Torn States*, 164.

¹⁷⁰ World Bank, Kosovo Partnership Program Snapshot September 2011, 2–3. Accessed August 22, 2012. http://siteresources.worldbank.org/KOSOVOEXTN/Resources/Kosovo_Snapshot.pdf.

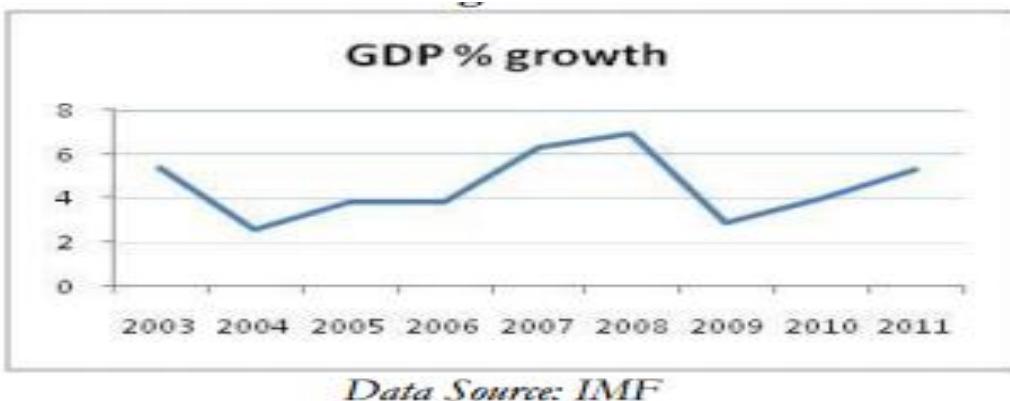


Figure 7. Kosovo, GDP% Growth between years 2002–11.

In sum, the international community failed to differentiate between economic reconstruction and economic development. “*Helping the poorest of the poor*”¹⁷¹ hindered the development of local markets. Although more than ten years have passed since intervention, providing people humanitarian aid, food, and other basic needs is still the issue in Kosovo. Humanitarian assistance for a protracted period of time undermines local farmers and merchants and undercuts efficient markets. Kosovo has actually needed entrepreneurs. Building roads, bridges, water irrigation, and telecommunication systems does not lead to sustainable growth.¹⁷² Efforts to reconstruct infrastructure were not enough alone to jumpstart the economy. As Schramm says “*dynamism of new firms constantly introducing innovations into the economy*” is the absolute solution for Kosovo’s economic problems.¹⁷³

3. Prospectus for Economic Development

a. *Positive*

Kosovo has a good rate of human and financial capital for achieving sustainable economic development. Given that these two factors are very important for achieving a growth-oriented economy, persistent economic development can be realized

¹⁷¹ Riegg, “Implementing Expeditionary and Entrepreneurial Economics” 165.

¹⁷² Ibid, 165.

¹⁷³ Schramm, “Expeditionary Economics: Spurring Growth after Conflicts and Disasters,” 89.

with the guidance of international organizations, like the IMF and World Bank. However, the country has to overcome major obstacles to utilize its human and financial capital with full efficiency.

(1) Human capital: Although the quality of human capital needs to be improved, high literacy rates and a considerable youth population create optimism. On the other hand, the large Kosovar diaspora can contribute with their experience and efficiency if they could be attracted to come back to their country of origin. The capital they accumulated abroad, with the right incentives, can transform small businesses, which could help jumpstart the economy.¹⁷⁴

Financial capital: Kosovo could grow its financial sector successfully. There are six commercial banks, nine insurance companies and fifteen micro-financing institutions operating in the country, under the supervision of the Central Banking Authority (CBAK).¹⁷⁵ The international community is generous towards Kosovo; if European countries recover from recession it may provide more money to increase financial capital. These aids can hinder economic growth unless they are managed well. International guidance is needed in this regard.

The focus of these efforts should be the implementation of right incentives and measures to encourage entrepreneurship, market forces, and indigenous businesses. Developing large, labor intense manufacturing industries such as textiles, clothing, and footwear in a country like Kosovo can absorb vast numbers of workers who might otherwise be unemployed and subject to ethnic tensions and underground networks.¹⁷⁶

b. Obstacles for Economic Recovery in Kosovo

(1) Political Ambiguity: Kosovo's unilateral declaration of independence did not resolve its political and economic problems. Although it is recognized by 89 states throughout the world, Russia and China in UN Security Council,

¹⁷⁴ World Bank, The World Bank in Kosovo, Program Snapshot, April 2012, 9.

¹⁷⁵ USAID, *Kosovo Economic Performance Assessment*, 25.

¹⁷⁶ Schramm, "Expeditionary Economics: Spurring Growth after Conflicts and Disasters," 94–95.

and Spain, Greece, Romania and Slovakia in the European Union opposed its independence. Moreover, Serbia still considers Kosovo a UN-administered region within the Serbian country. The uncertainty about the future of northern Kosovo, which is mostly populated by Kosovar Serbians, is another challenge for the social integration of Kosovar society. Political limbo remains the biggest challenge for economic development with its negative effects on investment.¹⁷⁷

(2) Diaspora remittances: One fifth of the Kosovar population has a family member working outside the country to send money for support. Remittances constitute a large portion of Kosovo's revenues. With regard to economic development, diaspora remittances have both negative and positive effects. On the one hand, they eliminate incentives for economic growth in society by discouraging people's determination to work and gain more money; on the other hand, they have rescued people from falling into poverty and extreme poverty levels. The remittances also contribute economic growth, if people can be persuaded to share out some portion of the money on savings and investment.¹⁷⁸

(3) Infrastructure: Despite the international community's strong effort towards recovering the infrastructure of the country, there are many infrastructural problems, like; electricity and the road system.

One of the major impediments to Kosovo's economic growth and development is inadequate and unreliable electricity. The Kosovo Energy Corporation (KEK) is not able to meet the demand for total electricity use both for industrial and household purposes. Power outages disrupt manufacturing, education and health services. As the population grows, demand for energy is also increasing.¹⁷⁹

Most of the roads are in bad condition in the country. Only 28 percent of the road system is considered to be in good condition. In the rail road system,

¹⁷⁷ World Bank, The World Bank in Kosovo, Program Snapshot, April 2012, 2. Accessed August 22, 2012.

http://siteresources.worldbank.org/INTKOSOVO/Resources/120412_Snapshot.pdf.

¹⁷⁸ USAID, *Kosovo Economic Performance Assessment*, 27.

¹⁷⁹ World Bank, The World Bank in Kosovo, Program Snapshot, April 2012, 6.

333 km of track is inactive due to electricity problems. The abysmal shape of the road system is another crippling factor for the economy, discouraging entrepreneurs and foreign investors as well.¹⁸⁰

F. RISK OF REVERT TO VIOLENCE

Kosovo's unilateral declaration of independence did not resolve its political and economic problems. The IC's initial strong efforts diminished in time. Management of the economy lacks coherence and a proper strategy. Political uncertainty, a low degree of foreign investment, a high unemployment rate, slow growth, and poverty are major factors hampering sustainable economic development. Economic risk factors are still relevant motivations for Kosovo to return to violence. Given that hostilities among different ethnic communities could not be reconciled, the risk of conflict should not be discounted in the region.¹⁸¹

Today, Kosovo has the youngest population in Europe. Twenty percent of the population is from 15–24 years old. Youth unemployment rate is estimated at more than 75 percent, which is five times higher than the average within the European Union.¹⁸² It has been estimated that roughly 200,000 young men and women will reach working age in the next five years, while the number of people reaching retirement age will be approximately 60,000. Demographic figures calls for an urgent need for economic improvement to reach sustainable peace.¹⁸³

¹⁸⁰ USAID, *Kosovo Economic Performance Assessment*, 31.

¹⁸¹ Ibid.,16.

¹⁸² World Bank, The World Bank in Kosovo, Program Snapshot, April 2012, 6.

¹⁸³ <http://www.kosovo.undp.org/en/Inclusive-Growth/Active-Labour-Market-Programme-ALMP-for-Youth-1130>. Accessed August 22, 2012.

THIS PAGE INTENTIONALLY LEFT BLANK

V. CONCLUSION

The literature on the causes of civil conflicts has long discussed the effects of greed and grievances on their outbreak. The thesis values the importance of both factors and their roles on stirring dissension in different circumstances. However, certain economic characteristics of a given country and insurgent groups' opportunities to sustain their rebellion activities there certainly require incorporating economic perspectives in the analysis of civil conflicts. Therefore, civil conflict analysis of any region should include economic perspectives. Engaging the political economy of civil wars requires at least defining the economic risk factors that cause civil conflicts, understanding the social and political aspects of war economies, and creating effective policy responses to post-conflict economic challenges.

First, defining important economic risk factors and presenting ways to eliminate them by examining past experiences may give valuable insights to domestic and international decision makers preventing civil wars. Many researches show that important risk factors, such as the existence of valuable natural resources¹⁸⁴, the poor economic performance of governments¹⁸⁵ and the availability of diaspora funding¹⁸⁶ pose great risk that countries will experience civil conflicts. Rebel groups' ability to sustain their activities significantly depends on the economic circumstances of a given country. Analyzing these risk factors is salient only if both national and international policy makers take them into consideration, evaluate their importance in the decision-making processes, and take preventive measures to prevent their reaching a dangerous level that may pose a threat to peace.

Second, understanding the social and political aspects of economic activities in wartime is crucial to implementing proper policies for a smooth transformation to peace-time conditions without creating opportunities for insurgent groups to recruit new rebels. Economic activity never stops, even in most severe war times. A war economy contains

¹⁸⁴ Lujala et al., "Valuable Natural Resources," 122.

¹⁸⁵ Muggah, "Stabilising Fragile States and Humanitarian Space," 34.

¹⁸⁶ Collier, "Economic Causes of Civil Conflict," 206.

all economic activities performed in wartime conditions. Transforming war economies into peacetime conditions is hard and takes a long time. War economies can be divided into three types: combat, shadow and coping economies. These interlinked economies involve different actors with dissimilar motivations using different mediums to implement their economic activities. In addition to predatory and profit-seeking concerns, coping and survival are the other considerations that should be taken into account when dealing with war economies.¹⁸⁷

Third, the economic challenges of an unstable post-conflict environment should be overcome as soon as possible in order to persuade rebels to give up their activities. Peace-makers usually tend to focus on political and military issues in the initial stages of post-conflict stabilization and reconstruction missions, but experience shows that achieving durable peace is more dependent on the economic recovery of a given country.¹⁸⁸ A fragile economic environment, shadow economy and peace spoilers are the three most important challenges that policy-makers have to deal with. It is not easy to offer an effective guideline to any given country, since the distinct economic characteristics of different countries entail dissimilar solutions. Nonetheless, establishing global control regimes for specific goods to curb insurgents' revenues,¹⁸⁹ building robust economic institutions to overcome shadow economies,¹⁹⁰ and alleviating socio-economic problems by providing economic opportunities to population¹⁹¹ are proven fundamental responses to cope with these challenges.

To sum up, this thesis claims that economic dimensions should be brought into consideration in a much broader sense when interpreting civil conflicts. Many studies on civil conflicts demonstrate that the risk of civil war, its continuity, and its termination are strongly correlated with economic variables rather than social elements. Contrary to general belief, inequality, an absence of liberal democratic norms and values, and ethnic

¹⁸⁷Goodhand, "From War Economy to Peace Economy," 155.

¹⁸⁸Wennmann, "Peace Processes, Business and New Futures after War," 15.

¹⁸⁹Ballentine and Nitzschke, "The Political Economy of Civil War ,”11.

¹⁹⁰Lujala, Rustad and Le Billon, "Valuable Natural Resources," 133

¹⁹¹Forman, "Achieving Socioeconomic Well- Being,"126.

and religious disparities do not seem to have a significant impact on the risk of civil conflict. Therefore, any civil conflict analysis should emphasize economic content.¹⁹² Defining the economic risk factors for preventing conflicts, understanding war economies for better evaluating socio-economic realities and attaining valuable results in the peace processes, and creating policy responses to cope with post-conflict economic challenges are three vital aspects in the economic reconstruction of a war-torn country. In many post-conflict settings, the ability to manage these challenges largely determines the sustainability of peace or a return to violence.

¹⁹² Nitzschke and Studdard, “The Legacies of War Economies,” 223.

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF REFERENCES

- Ballentine, Karen. "Beyond Greed and Grievance: Reconsidering the Economic Dynamics of Armed Conflict," in Karen Ballentine & Jake Sherman(eds.), *The Political Economy of Armed Conflict, Beyond Greed & Grievance*. Colorado: Lynne Rienner Publishers, 2003.
- Ballentine, Karen and Nitzschke, Heiko. "Beyond Greed and Grievance: Policy Lessons from Studies in the Political Economy of Armed Conflict," *IPA Policy Report*. New York: International Peace Academy, 2003. Accessed August 22, 2012. http://www.worldpolicy.newschool.edu/wpi/projects/arms/study/bak05_1.pdf.
- Ballentine, Karen and Nitzschke, Heiko. "The Political Economy of Civil War and Conflict Transformation," Berghof Research Center for Constructive Conflict Management, 2005. Accessed August 22, 2012. http://www.berghof-handbook.net/documents/publications/dialogue3_ballentine_nitzschke.pdf
- Bannon, Ian and Collier, Paul. "Natural Resources and Violent Conflict: What We Can Do?," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions*. Washington D.C.: World Bank Publications, 2003.
- Castillo, Graciana del. *Rebuilding War-Torn States: The Challenge of Post-Conflict Economic Reconstruction*. Oxford University Press, 2008.
- Cockayne, James. "Crime, Corruption and Violent Economies," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series. New York : Routledge, 2010.
- Collier, Paul et al. *Breaking the Conflict Trap: Civil War and Development Policy*. Washington D.C.: World Bank Publications, 2003.
- Collier, Paul. "Economic Causes of Civil Conflict and Their Implications for Policy," in Crocker, Hampson and Aall (eds.), *Leashing the Dogs of War: Conflict Management in a Divided World*. Washington, D.C. : United States Institute of Peace Press, 2007.
- Collier, Paul. *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done About It*. New York: Oxford University Press, 2007.

Collier, Paul. "Doing Well Out of War: Economic Perspective," in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars.* Boulder: Lynne Rienner Publishers, 2000.

Demekas, Dimitri G., Herderschee, Johannes, and Jacobs, Davina F. Kosovo: Progress in Institution Building and Economic Policy Challenges. Washington, D.C.: International Monetary Fund, December 6, 2001.

Demmers, Joell. "New Wars And Diasporas: Suggestions for Research and Policy," *Journal of Peace Conflict & Development*, Issue 11, November 2007 ,7. Accessed August 22, 2012. [http://www.peacestudiesjournal.org.uk/dl/PCD_ISSUE_11_ARTICLE_New Wars and Diasporas_Joell_Demmers.PDF](http://www.peacestudiesjournal.org.uk/dl/PCD_ISSUE_11_ARTICLE_New%20Wars%20and%20Diasporas_Joell_Demmers.PDF)

De Soysa, Indra. "The Resource Curse: Are Civil Wars Are Driven by Rapacity or Paucity?," in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars.* Boulder: Lynne Rienner Publishers, 2000.

Dobbins, James McGinn and Keith John G. Crane. *America's Role in Nation Building: From Germany to Iraq.* Santa Monica: RAND Corporation, 2003.

Forman, Johanna Mendelson. "Achieving Socioeconomic Well-Being in Post-Conflict Settings," *Washington Quarterly*, Autumn 2002. Accessed August 22, 2012. http://pdf.usaid.gov/pdf_docs/PCaab119.pdf.

Gamba, Virginia and Richard Cornwell. "Arms, Elites, and Resources in the Angolan Civil War," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives.* Adelphi Series. New York : Routledge, 2010.

Goodhand, Jonathan. "From War Economy to Peace Economy? Reconstruction and State Building in Afghanistan," *Journal of International Affairs*, Vol. 58, No. 1, 2004. Accessed August 22, 2012. http://www.relooney.info/SI_Expeditionary/Afghanistan-Entrepreneurship_5.pdf

Hamre, John J. and Gordon R. Sullivan. "Toward Post-Conflict Reconstruction," *The Washington Quarterly*, Autumn 2002. Accessed August 22, 2012. <http://www.twq.com/02autumn/hamre.pdf>

Hazen, Jennifer. "War Transitions and Armed Groups," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series. New York : Routledge, 2010.

Joshua, Kaldor-Robinson. "The Virtual and the Imaginary: The Role of Diasporic New Media in the Construction of a National Identity during the Break-up of Yugoslavia." *Oxford Development Studies*, Vol. 30, No. 2, 2002.

Keen, David. "Incentives and Disincentives for Violence," in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars.*" Boulder: Lynne Rienner Publishers, 2000.

Kosovo Information Page, State Department website. Accessed August 22, 2012.
<http://www.state.gov/p/eur/ci/kv/>.

Lujala, Paivi, Rustad, Siri Aas and Philippe Le Billon. "Valuable Natural Resources in Conflict Affected States," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series. New York : Routledge, 2010.

McMahon, Patrice C. and Jon Western. "Out of Sight, Out of Mind: Post-Conflict Economic Planning in the Balkans" in *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics*. Kauffman Foundation and Command and General Staff College Foundation, 2010.

Muggah, Robert, "Stabilising Fragile States and Humanitarian Space," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series. New York : Routledge, 2010.

Nitzschke, Heiko and Kaysie Studdard. "The Legacies of War Economies: Challenges and Options for Peacemaking and Peacebuilding," *International Peacekeeping*, 12: 2. London: Routledge, 2005.

Reno, William. "Shadow States and the Political Economy of Civil Wars," in Mats Berdal and David M. Malone(eds.), *Greed and Grievances: Economic Agendas in Civil Wars.*" Boulder: Lynne Rienner Publishers, 2000.

Riegg, Nicholas H. "Implementing Expeditionary and Entrepreneurial Economics: Iraq and Afghanistan" in *Proceedings from the Summit on Entrepreneurship and Expeditionary Economics*. Kauffman Foundation and Command and General Staff College Foundation, 2010.

Ross, Michael. "The Natural Resource Curse: How Wealth Can Make You Poor," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions*. Washington D.C.: World Bank Publications, 2003.

Schramm, Carl. "Expeditionary Economics: Spurring Growth after Conflicts and Disasters," *Foreign Affairs*. May\June, 2010.

USAID, Kosovo Economic Performance Assessment, May 2008. Accessed August 22, 2012. http://pdf.usaid.gov/pdf_docs/PNADL767.pdf 7

Viner, Jonathan M. and Trifin J. Roule." Follow the Money: The Finance of Illicit Resource Extraction," in Ian Bannon and Paul Collier(eds.), *Natural Resources and Violent Conflict Options and Actions*. Washington D.C.: World Bank Publications, 2003.

Wennmann, Achim. " Peace Processes, Business and New Futures after War," in Mats Berdal and Achim Wennmann(eds.), *Ending Wars, Consolidating Peace: Economic Perspectives*, Adelphi Series. New York : Routledge, 2010.

Wolff, Stefan. *Ethnic Conflict: A Global Perspective*, Oxford: Oxford University Press, 2006.

World Bank, Consumption Poverty in the Republic of Kosovo in 2009, May 2011, 4. Accessed August 22, 2012.
http://siteresources.worldbank.org/INTKOSOVO/Resources/Kosovo_Poverty_for_web_eng.pdf

World Bank, Security Development Report, Part 2 Vulnerability to Violence, 2011.

World Bank, Kosovo Partnership Program Snapshot September 2011, 2–3.
http://siteresources.worldbank.org/KOSOVOEXTN/Resources/Kosovo_Snapshot.pdf. Accessed August 22, 2012.

World Bank, World Bank in Kosovo, Program Snapshot, April 2012. Accessed August 22, 2012.

http://siteresources.worldbank.org/KOSOVOEXTN/Resources/Kosovo_Snapshot.pdf

World Bank, World Development Report 2011: Conflict, Security and Development. Washington, DC: The World Bank, April 2011.

Yannis, Alexandros. "Kosovo: The Political Economy of Conflict and Peacebuilding," in Karen Ballentine & Jake Sherman(eds.), *The Political Economy of Armed Conflict, Beyond Greed & Grievance*. Colorado: Lynne Rienner Publishers, 2003.

THIS PAGE INTENTIONALLY LEFT BLANK

INITIAL DISTRIBUTION LIST

1. Defense Technical Information Center
Ft. Belvoir, Virginia
2. Dudley Knox Library
Naval Postgraduate School
Monterey, California
3. Kara Harp Okulu Kutuphanesi
Kara Harp Okulu
Bakanliklar, Ankara, Turkey
4. Robert E. Looney
National Security Affairs Department
Naval Postgraduate School
Monterey, California
5. Ryan Gingeras
National Security Affairs Department
Naval Postgraduate School
Monterey, California
6. Serdar Hacisalihoglu
Savunma Bilimleri Enstitusu
Kara Harp Okulu
Bakanliklar, Ankara, Turkey